POWER INTEGRATIONS INC

FORM 10-Q
(Quarterly Report)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

☒ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2012

or

☐ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from ______ to ______

Commission File Number 0-23441

POWER INTEGRATIONS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**94-3065014**
(State or other jurisdiction of Incorporation or organization)	**(I.R.S. Employer Identification No.)**

5245 Hellyer Avenue, San Jose, California, 95138
(Address of principal executive offices) (Zip code)

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding at April 20, 2012
Common Stock, $.001 par value	28,380,485

POWER INTEGRATIONS, INC.

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Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q includes a number of forward-looking statements that involve many risks and uncertainties. Forward-looking statements are identified by the use of the words “would”, “could”, “will”, “may”, “expect”, “believe”, “should”, “anticipate”, “outlook”, “if”, “future”, “intend”, “plan”, “estimate”, “predict”, “potential”, “targets”, “seek” or “continue” and similar words and phrases, including the negatives of these terms, or other variations of these terms, that denote future events. 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-Q. These factors include, but are not limited to, the risks described under Item 1A of Part II — “Risk Factors,” Item 2 of Part I — “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this Quarterly Report on Form 10-Q, including: our quarterly operating results are volatile and difficult to predict, and if we fail to meet the expectations of public market analysts or investors, the market price of our common stock may decrease significantly; 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; 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; 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 being audited by the Internal Revenue Service which is asserting that we owe additional taxes relating to a number of tax related position; and our international sales activities account for a substantial portion of our net revenues, which subjects us to substantial risks. We make these forward-looking statements based upon information available on the date of this Form 10-Q, 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 except as otherwise required by securities regulations.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

POWER INTEGRATIONS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(In thousands)

	March 31, 2012	December 31, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 147,155	$ 139,836
Short-term marketable securities	66,855	40,899
Accounts receivable, net of allowances of $216 and $215 in 2012 and 2011, respectively (Note 2)	16,696	9,396
Inventories	42,851	52,010
Deferred tax assets	890	892
Prepaid expenses and other current assets	6,222	7,068
Total current assets	280,669	250,101
LONG-TERM MARKETABLE SECURITIES	—	32,041
PROPERTY AND EQUIPMENT, net	89,695	88,241
INTANGIBLE ASSETS, net	8,663	8,852
GOODWILL	14,786	14,786
DEFERRED TAX ASSETS	12,716	12,387
OTHER ASSETS	43,724	26,511
Total assets	$ 450,253	$ 432,919
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 15,165	$ 16,532
Accrued payroll and related expenses	5,279	5,911
Deferred income on sales to distributors	9,373	7,883
Other accrued liabilities	2,661	2,305
Total current liabilities	32,478	32,631
LONG-TERM INCOME TAXES PAYABLE	35,190	34,368
Total liabilities	67,668	66,999
COMMITMENTS AND CONTINGENCIES (Notes 9, 11 and 12)		
STOCKHOLDERS' EQUITY:		
Common stock	28	28
Additional paid-in capital	168,918	158,646
Accumulated other comprehensive income	398	50
Retained earnings	213,241	207,196
Total stockholders' equity	382,585	365,920
Total liabilities and stockholders' equity	$ 450,253	$ 432,919

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

POWER INTEGRATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(In thousands, except per share amounts)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
NET REVENUES	$ 71,773	$ 76,762
COST OF REVENUES	37,181	40,339
GROSS PROFIT	34,592	36,423
OPERATING EXPENSES:		
Research and development	10,640	10,023
Sales and marketing	8,139	8,248
General and administrative	7,092	6,475
Total operating expenses	25,871	24,746
INCOME FROM OPERATIONS	8,721	11,677
OTHER INCOME		
Other income, net	615	442
Total other income	615	442
INCOME BEFORE PROVISION FOR INCOME TAXES	9,336	12,119
PROVISION FOR INCOME TAXES	1,875	2,265
NET INCOME	$ 7,461	$ 9,854
EARNINGS PER SHARE:		
Basic	$ 0.26	$ 0.34
Diluted	$ 0.25	$ 0.33
SHARES USED IN PER SHARE CALCULATION:		
Basic	28,227	28,628
Diluted	29,435	30,187

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

POWER INTEGRATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)
(In thousands)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net income	$ 7,461	$ 9,854
Other comprehensive income, net of tax:		
Unrealized gain on marketable securities	291	—
Foreign currency translation adjustments	57	50
Total other comprehensive income	$ 348	$ 50
Total comprehensive income	$ 7,809	$ 9,904

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

POWER INTEGRATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(In thousands)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 7,461	$ 9,854
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,732	3,682
Amortization of intangibles	189	243
Gain on sale of property and equipment	(1)	—
Stock-based compensation expense	3,031	2,504
Amortization of premium on marketable securities	309	439
Non-cash interest income from SemiSouth note	(157)	—
Deferred income taxes	(327)	399
Provision for accounts receivable allowances	—	22
Excess tax benefit from stock options exercised	(198)	(398)
Tax benefit associated with employee stock plans	782	783
Change in operating assets and liabilities:		
Accounts receivable	(7,300)	(7,622)
Inventories	9,161	(964)
Prepaid expenses and other assets	1,306	1,435
Accounts payable	1,485	(2,908)
Taxes payable and accrued liabilities	604	(525)
Deferred income on sales to distributors	1,490	(1,269)
Net cash provided by operating activities	21,567	5,675
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(7,471)	(7,248)
Proceeds from sale of property and equipment	2	—
Acquisition	—	(6,901)
Increase in financing lease receivable	(383)	(5,642)
Collections of financing lease receivable	299	102
Loan to SemiSouth	(18,000)	—
Purchases of marketable securities	—	(11,508)
Proceeds from maturities of marketable securities	6,065	1,300
Net cash used in investing activities	(19,488)	(29,897)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock under employee stock plans	6,457	7,288
Payments of dividends to stockholders	(1,415)	(1,437)
Excess tax benefit from stock options exercised	198	398
Net cash provided by financing activities	5,240	6,249
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,319	(17,973)

	Three Months Ended March 31,	
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	139,836	155,667
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 147,155	$ 137,694
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Unpaid property and equipment	$ 965	$ 1,917
Receipt of SemiSouth purchase option	$ 6,216	$ —
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for income taxes, net of refunds	$ 630	$ 118

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

POWER INTEGRATIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION:

The condensed consolidated financial statements include the accounts of Power Integrations, Inc., a Delaware corporation (the "Company"), and its wholly owned subsidiaries. Significant intercompany accounts and transactions have been eliminated.

While the financial information furnished is unaudited, the condensed consolidated financial statements included in this report reflect all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for the fair presentation of the results of operations for the interim periods covered and the financial condition of the Company at the date of the interim balance sheet in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The results for interim periods are not necessarily indicative of the results for the entire year. The condensed consolidated financial statements should be read in conjunction with the Power Integrations, Inc. consolidated financial statements and the notes thereto for the year ended December 31, 2011 included in its Form 10-K filed on February 29, 2012 with the Securities and Exchange Commission.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

No significant changes have been made to the Company's significant accounting policies disclosed in Note 2, *Summary of Significant Accounting Policies* , in its Annual Report on Form 10-K, filed on February 29, 2012 , for the year ended December 31, 2011 . The accounting policy information below is to aid in the understanding of the financial information disclosed.

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

In the first quarter of 2012, the Company changed its investment policy to permit the sale of long-term and short-term investments prior to their stated maturity date. The Company generally holds securities until maturity; however, they may now 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 change in policy the Company classifies its investment portfolio as available-for-sale as opposed to held-to-maturity as of March 31, 2012. Prior to March 31, 2012, the Company classified its investments as held-to-maturity. In connection with this change in investment policy the Company classified all investments with an original maturity date greater than three months as short-term investments in its Condensed Consolidated Balance Sheet. The Company's short-term investment portfolio is invested in highly liquid financial instruments with maturities greater than three months. As of March 31, 2012 and December 31, 2011 , the Company's marketable securities consisted of U.S. government-backed securities, municipal bonds, corporate commercial paper, certificates of deposit and other high-quality commercial securities.

Amortized cost and estimated fair market value of investments classified as available-for-sale at March 31, 2012 , are as follows (in thousands):

POWER INTEGRATIONS, INC.

NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Investments due in less than 3 months:				
Commercial paper	$ 16,672	$ 2	$ —	$ 16,674
Corporate securities	6,439	30	—	6,469
Total	$ 23,111	$ 32	$ —	$ 23,143
Investments due in 4-12 months:				
Corporate securities	$ 19,694	$ 141	$ —	$ 19,835
Certificates of deposit	10,000	1	—	10,001
Total	$ 29,694	$ 142	$ —	$ 29,836
Investments due in more than 12 months:				
Corporate securities	$ 30,433	$ 117	$ —	$ 30,550
Total	$ 30,433	$ 117	$ —	$ 30,550
Total investment securities	$ 83,238	$ 291	$ —	$ 83,529

Amortized cost and estimated fair market value of investments classified as held-to-maturity at December 31, 2011 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Investments due in less than 3 months:				
Commercial paper	$ 9,849	$ —	$ —	$ 9,849
Corporate securities	6,098	9	(1)	6,106
Total	$ 15,947	$ 9	$ (1)	$ 15,955
Investments due in 4-12 months:				
Corporate securities	$ 24,801	$ 179	$ (23)	$ 24,957
Certificates of deposit	10,000	1	—	10,001
Total	$ 34,801	$ 180	$ (23)	$ 34,958
Investments due in more than 12 months:				
Corporate securities	$ 32,041	$ 5	$ (178)	$ 31,868
Total	$ 32,041	$ 5	$ (178)	$ 31,868
Total investment securities	$ 82,789	$ 194	$ (202)	$ 82,781

As of March 31, 2012 the Company had no marketable securities in an unrealized loss position. The Company evaluated the nature of the investments with a loss position at December 31, 2011, which were primarily high-quality commercial securities, and determined the unrealized losses were not other-than-temporary.

Revenue Recognition

Product revenues consist of sales to original equipment manufacturers ("OEMs"), merchant power supply manufacturers and distributors. Approximately 71% of the Company's net product sales were made to distributors in the three months ended March 31, 2012 , and 71% in the twelve months ended December 31, 2011 . 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 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. 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. 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 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 sales to distributors until the Company's distributors report that they have sold the Company's products to their customers. The Company's recognition of such distributor sell-through 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 condensed consolidated balance sheets. The total deferred revenue as of March 31, 2012 and December 31, 2011 was approximately $18.9 million and $16.7 million , respectively. The total deferred cost as of March 31, 2012 and December 31, 2011 was approximately $9.5 million and $8.8 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 reserve appears as a reduction to accounts receivable 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.

Common Stock Repurchases and Common Stock Dividend

In February 2011, the board of directors authorized the use of $50.0 million for the repurchase of the Company's common stock, with repurchases to be executed according to certain pre-defined price/volume guidelines set by the board of directors. In the twelve months ended December 31, 2011 , the Company repurchased 1.5 million shares for a total cost of $50.0 million , concluding this repurchase program. In November 2011, the board of directors authorized the use of an additional $30.0 million for the repurchase of the Company's common stock, and in March 2012, the Company canceled its $30 million stock repurchase program in connection with its purchase agreement to acquire CT-Concept Technologie AG. Refer to note 14, *Acquisition* , for acquisition details.

In October 2010, 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 2011. The first quarterly dividend payment of approximately $1.4 million was made on March 31, 2011, the second quarterly dividend payment of $1.4 million was made on June 30, 2011 , the third payment of $1.4 million was made on September 30, 2011, and the final 2011 dividend payment of $1.4 million was made on December 30, 2011. 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 first quarterly dividend payment of approximately $1.4 million was made on March 30, 2012, with subsequent quarterly payments to be approximately the same amount. 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.

Use of 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, income tax, stock-based compensation and inventories. These estimates are based on historical facts and various other assumptions that the Company believes to be reasonable at the time the estimates are made.

Components of the Company's Condensed Consolidated Balance Sheet

Accounts Receivable (in thousands):

	March 31, 2012	December 31, 2011
Accounts receivable trade	$ 39,311	$ 27,972
Accrued ship and debit and rebate claims	(22,399)	(18,361)
Allowance for doubtful accounts	(216)	(215)
Total	$ 16,696	$ 9,396

Prepaid Expenses and Other Current Assets (in thousands):

	March 31, 2012	December 31, 2011
Prepaid legal fees	$ 2,625	$ 3,500
Prepaid income tax	148	118
Prepaid maintenance agreements	540	669
Interest receivable	570	625
Other	2,339	2,156
Total	$ 6,222	$ 7,068

Other Assets (in thousands):

	March 31, 2012	December 31, 2011
Prepaid royalty (Note 15)	$ 10,000	$ 10,000
Investment in third party (Note 15)	7,000	7,000
Note receivable, net of interest discount (Note 15)	11,965	—
Financing lease receivables and deposits (Note 16)	6,849	7,558
Purchase option (Note 15)	6,216	—
Other	1,694	1,953
Total	$ 43,724	$ 26,511

3. STOCK PLANS AND SHARE-BASED COMPENSATION:

Stock Plans

As of March 31, 2012 , 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 awards and other stock awards to employees, directors and consultants. As of March 31, 2012 , the maximum remaining number of shares that may be issued under the 2007 Plan was 6,352,885 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 (that was adopted by the board of directors on January 27, 2009) to nonemployee directors have been made primarily under the 2007 Plan. The Directors Equity Compensation Program provides in certain circumstances (depending on the status of the particular director's holdings of Company stock options) for the automatic grant of nonstatutory stock options to nonemployee directors of the Company on the first trading day of July in each year over their period of service on the board of directors. Further, each future nonemployee director of the Company would be granted under the 2007 Plan: (a) on the first trading day of the month following commencement of service, an option to purchase the number of shares of common stock equal to: the fraction of a year between the date of the director's appointment to the board of directors and the next July 1, multiplied by 8,000 , which option shall vest on the next July 1 st ; and (b) on the first trading day of July following commencement of service, an option to purchase 24,000 shares vesting monthly over the three year period commencing on the grant date. 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 cancelled 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 3,000,000 shares of common stock were reserved for issuance to employees under the Purchase Plan. As of March 31, 2012 , 2,412,036 shares had been purchased and 587,964 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:

POWER INTEGRATIONS, INC.

NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Expected Volatility . The Company calculates expected volatility as an average of implied volatility and historical volatility.

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.

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 three months ended March 31, 2012 and March 31, 2011 (in thousands).

	Three Months Ended March 31,	
	2012	**2011**
Cost of revenues	$ 245	$ 239
Research and development	1,120	811
Sales and marketing	747	667
General and administrative	919	787
Total stock-based compensation expense	$ 3,031	$ 2,504

As of March 31, 2012 there were approximately $5.0 million , net of expected forfeitures, of total unrecognized compensation expense related to stock options. The unrecognized compensation expense at March 31, 2012 is expected to be recognized over a weighted-average period of 1.7 years.

As of March 31, 2012 , the Company had $11.3 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock units. The unamortized compensation expense will be recognized on a straight-line basis over a weighted-average period of 2.6 years.

As of March 31, 2012 , the Company had $2.8 million of total unrecognized compensation expense, net of estimated forfeitures, related to performance-based share grants. The unamortized compensation expense will be recognized on a straight-line basis, and is expected to be recognized over the remainder of 2012 .

As of March 31, 2012 , the total unrecognized compensation cost under the Purchase Plan to purchase the Company's common stock was approximately $0.4 million . The Company will amortize this cost on a straight-line basis over approximately 0.5 years.

Stock compensation expense in the three months ended March 31, 2012 was $3.0 million ; consisting of approximately $0.9 million related to stock options, $0.4 million related to performance shares, $1.4 million related to restricted stock units and $0.3 million related to the Purchase Plan.

Stock compensation expense in the three months ended March 31, 2011 , was $2.5 million ; consisting of approximately $1.2 million related to stock options, $0.3 million related to performance shares, $0.6 million related to restricted stock units and $0.3 million related to the Purchase Plan.

POWER INTEGRATIONS, INC.

NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company did not grant stock options in the first quarter of 2012 or 2011, 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:

	Three Months Ended March 31,	
	2012	2011
Risk-free interest rates	0.09%	0.17%
Expected volatility rates	48%	37%
Expected dividend yield	0.54%	0.51%
Expected term of purchase right (years)	0.5	0.5
Weighted-average estimated fair value of purchase rights	$10.42	$9.40

A summary of stock option activity under the Plans, excluding performance-based shares and restricted stock units, as of March 31, 2012 , and changes during the three months 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	—	—		
Exercised	(215)	19.58		
Forfeited or expired	(3)	21.09		
Outstanding at March 31, 2012	3,339	$ 24.29	4.52	$ 43,032
Exercisable at March 31, 2012	2,866	$ 23.44	3.96	$ 39,249
Vested and expected to vest at March 31, 2012	3,322	$ 24.24	4.50	$ 42,986

The Company did not grant stock options in the three months ended March 31, 2012 and 2011 ; since 2010 the Company's equity grants to new hires and its annual incentive grants to non-executive employees have been primarily in the form of RSUs. The total intrinsic value of options exercised during the three months ended March 31, 2012 and 2011 was $3.9 million and $6.2 million , respectively.

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 granted from the 2007 Plan will reduce the number of shares available for issuance under the 2007 Plan by 2.0 shares.

During the three months ended March 31, 2012 , the Company issued approximately 96,000 performance-based awards to employees and executives. As the net revenue and non-GAAP operating earnings are considered performance conditions, expenses associated with these awards, net of estimated forfeitures, are recorded throughout the year depending on the number of shares expected to be earned based on progress toward the performance targets. The cost of 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.

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NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In January 2012, it was determined that the Company had not reached the minimum level of the established performance targets for the performance-based awards granted in 2011. Accordingly, the 93,000 performance-based awards granted in the first quarter of 2011 were canceled.

A summary of performance-based awards outstanding as of March 31, 2012 , and activity during the three months 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	96	37.28		
Vested	—	—		
Forfeited or expired	—	—		
Outstanding at March 31, 2012	96	$ 37.28	0.75	$ 3,556
Vested and expected to vest at March 31, 2012	92		0.75	$ 3,409

The weighted-average grant-date fair value per share of performance-based awards granted in the three months ended March 31, 2012 and 2011 was approximately $37.28 and $36.90 , respectively. The grant date fair value of awards released, which were fully vested, in the three months ended March 31, 2011 was approximately $3.0 million . There were no performance-based awards released in the three months ended March 31, 2012 , as the performance-based awards granted in 2011 were canceled.

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 cost of the 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 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 2.0 shares.

A summary of RSUs outstanding as of March 31, 2012 , and changes during the three months 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	3	35.12		
Vested	(5)	37.23		
Forfeited or expired	(6)	37.09		
Outstanding at March 31, 2012	450	$ 36.04	1.38	$ 16,708
Outstanding and expected to vest at March 31, 2012	420		1.37	$ 15,596

The weighted-average grant-date fair value of RSUs awarded in the three months ended March 31, 2012 and 2011 was approximately $35.12 and $38.66 , respectively. The grant date fair value of awards vested in the three months ended March 31, 2012 and 2011 was approximately $0.2 million and $0.1 million , respectively.

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, when available, 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. In the first quarter of 2012, the Company changed its investment policy to allow the sale of long-term and short-term investments prior to their stated maturity date. 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. As a result of this change in policy the Company classified its investment portfolio as available-for-sale as opposed to held-to-maturity as of March 31, 2012. The Company's investments classified as Level 1 and Level 2 are available-for-sale investments, and were recorded at fair market value.

The fair value hierarchy of the Company's marketable securities at March 31, 2012 and December 31, 2011 , was as follows (in thousands):

	Fair Value Measurement at March 31, 2012		
Description	**March 31, 2012**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**
Commercial paper	$ 16,674	$ —	$ 16,674
Money market funds	29,658	29,658	—
Certificates of deposit	10,001	—	10,001
Corporate securities	56,854	—	56,854
Total	$ 113,187	$ 29,658	$ 83,529

	Fair Value Measurement at December 31, 2011		
Description	**December 31, 2011**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**
Commercial paper	$ 9,849	$ —	$ 9,849
Money market funds	30,190	30,190	—
Certificates of deposit	10,000	—	10,000
Corporate securities	62,940	—	62,940
Total	$ 112,979	$ 30,190	$ 82,789

The Company did not transfer any investments between Level 1, Level 2 or Level 3 of the fair-value hierarchy in the three months ended March 31, 2012 and the twelve months ended December 31, 2011.

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On October 22, 2010, the Company entered into an agreement with SemiSouth Laboratories, as amended, pursuant to which the Company may be obligated to acquire SemiSouth if SemiSouth meets certain financial performance conditions on or before December 31, 2013. At March 31, 2012 , the Company determined the fair value of this potential obligation to be zero. The Company developed its own assumptions using Level 2 inputs in its fair-market valuation using a market approach valuation technique to determine the fair value of this obligation. The Company updates the estimated fair value of this potential obligation quarterly. Any changes are recorded in its unaudited condensed consolidated statements of income. In March 2012, in consideration for the loan agreement discussed below, the Company entered into an amended agreement with SemiSouth which established a maximum purchase price related to both the Company's option to acquire SemiSouth ("Purchase Option") and its potential obligation to acquire SemiSouth (as discussed above). The Company used Level 3 inputs in its fair-market valuation utilizing the income-approach valuation technique. The Company prepared a discounted cash flow analysis using the following unobservable inputs: weighted average cost of capital, long-term revenue growth, control premium, and discount for lack of marketability. The Company then used the Black-Scholes option pricing model to determine the fair value of the Company's purchase option to be approximately $6.2 million . The Company's valuation technique derived inputs principally from comparable company market data (i.e., correlation values). The Company considers this to be a Level 3 investment as there was no specific market data for this instrument or similar instruments. The Company has not elected the fair value option for this purchase option, under ASC 825. See Note 15, *Investment in Third Party* , below for further details on the valuation method used.

In March 2012 the Company loaned SemiSouth $18.0 million , and in exchange the Company was issued a promissory note and received the modification discussed above to establish a maximum price under the Purchase Option. The note has been classified as Level 3 in the fair-value hierarchy, as there was no market data for this instrument. The estimated fair value of the note was approximately $12.0 million at March 31, 2012 , consisting of the promissory note of $18.0 million , net of the of the unamortized interest discount related to the $6.2 million purchase option (see Note 15, *Investment in Third Party* , below for further details on the SemiSouth loan). The fair value was estimated by calculating the present value of cash flows using a market discount rate for similar investments. The Company intends to hold the note to maturity, which occurs in March 2014. The following table presents the changes in Level 3 investments for the three months ended March 31, 2012 , for investments that are measured at fair value on a recurring basis (in thousands):

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)
	Note Receivable
Beginning balance at January 1, 2012	$ —
Purchases and issuances	11,965
Settlements	—
Ending balance at March 31, 2012	$ 11,965

5. INVENTORIES:

Inventories (which consist of costs associated with the purchases of wafers from 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):

	March 31, 2012	December 31, 2011
Raw materials	$ 9,323	$ 12,389
Work-in-process	7,930	7,841
Finished goods	25,598	31,780
Total	$ 42,851	$ 52,010

6. GOODWILL AND INTANGIBLE ASSETS:

The carrying amount of goodwill was $14.8 million as of March 31, 2012 and December 31, 2011 .

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NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intangible assets consist primarily of acquired licenses, 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 acquired license or patent rights, which range from five to ten years, with the exception of $4.7 million of in-process research and development which will be amortized once the development is completed and products are available for sale. The Company does not expect the amortization for its in-process research and development to begin in 2012 . Amortization for acquired intangible assets was approximately $0.2 million and $0.2 million in the three months ended March 31, 2012 and March 31, 2011 , respectively. The Company does not believe there is any significant residual value associated with the following intangible assets:

	March 31, 2012			December 31, 2011		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
	(in thousands)					
In-process research and development	$ 4,690	$ —	$ 4,690	$ 4,690	$ —	$ 4,690
Technology licenses	3,000	(1,800)	1,200	3,000	(1,725)	1,275
Patent rights	1,949	(1,949)	—	1,949	(1,949)	—
Developed technology	2,920	(915)	2,005	2,920	(829)	2,091
Customer relationships	910	(142)	768	910	(114)	796
Other intangibles	37	(37)	—	37	(37)	—
Total intangible assets	$ 13,506	$ (4,843)	$ 8,663	$ 13,506	$ (4,654)	$ 8,852

The estimated future amortization expense related to intangible assets at March 31, 2012 is as follows:

Fiscal Year	Estimated Amortization (in thousands)
2012 (remaining 9 months)	$ 566
2013	755
2014	755
2015	592
2016	367
Thereafter	938
Total (1)	$ 3,973

(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.

7. SIGNIFICANT CUSTOMERS AND EXPORT SALES:

Segment Reporting

The Company is organized and operates as one reportable segment, the design, development, manufacture and marketing of proprietary, high-voltage, analog integrated circuits for use primarily in the AC-DC power conversion market. 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.

Customer Concentration

Ten customers accounted for approximately 66% and 67% of net revenues for the three months ended March 31, 2012 and March 31, 2011 , 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 accounted for 10% or more of total net revenues:

	Three Months Ended March 31,	
Customer	**2012**	**2011**
A	20%	19%
B	12%	12%

Customers A and B 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 consist principally of cash investments, trade receivables, the Company's note from SemiSouth and the Company's lease line of credit to SemiSouth. The Company has cash investment policies that limit cash investments to low-risk investments. With respect to the Company's agreements with SemiSouth, the Company monitors SemiSouth's credit quality on an ongoing basis. If the credit worthiness of SemiSouth diminishes, the Company will establish a specific reserve against the lease line receivable and / or note receivable. 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. As of March 31, 2012 and December 31, 2011 , 78% and 79% , respectively, of accounts receivable were concentrated with the Company's top 10 customers.

The following customers represented 10% or more of accounts receivable:

Customer	**March 31, 2012**	**December 31, 2011**
A	26%	36%
B	18%	10%

Customers A and B 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 through its sales personnel and a worldwide network of distributors. As a percentage of total net revenues, international sales, which consist of domestic and foreign sales to distributors and direct customers outside of the Americas, comprise the following:

	Three Months Ended March 31,	
	2012	2011
Hong Kong/China	42%	34%
Taiwan	17%	24%
Korea	15%	17%
Western Europe (excluding Germany)	11%	10%
Japan	6%	6%
Singapore	2%	3%
Germany	1%	1%
Other	2%	1%
Total foreign revenue	96%	96%

The remainder of the Company’s sales are to customers within the Americas, primarily located in the United States.

Product Sales

Approximately 97% to 99% of the Company's sales in the three months ended March 31, 2012 and 2011 , respectively, were from its three primary families of low-power AC-DC power-conversion products. Approximately 1% to 3% of the Company's sales came from other product families.

Revenue mix by product family for the three months ended March 31, 2012 and 2011 was as follows:

	Three Months Ended March 31,	
Product Family	2012	2011
LinkSwitch	41%	40%
TinySwitch	33%	35%
TOPSwitch	23%	23%
Other	3%	2%

8. EARNINGS PER SHARE:

Basic earnings per share are calculated by dividing net income by the weighted-average shares of common stock outstanding during the period. Diluted earnings per share are calculated by dividing net income 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.

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

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	Three Months Ended March 31, 2012	2011
Basic earnings per share:		
Net income	$ 7,461	$ 9,854
Weighted-average common shares	28,227	28,628
Basic earnings per share	$ 0.26	$ 0.34
Diluted earnings per share (1):		
Net income	$ 7,461	$ 9,854
Weighted-average common shares	28,227	28,628
Effect of dilutive securities:		
Employee stock plans	1,208	1,559
Diluted weighted-average common shares	29,435	30,187
Diluted earnings per share	$ 0.25	$ 0.33

(1) The Company includes the shares underlying performance-based awards in the calculation of diluted earnings per share when they become contingently issuable per ASC 260-10, *Earnings per Share* and excludes such shares when they are not contingently issuable. The Company has excluded all performance-based awards underlying the fiscal 2012 and 2011 awards as those shares were not contingently issuable as of the end of the period.

Approximately 297,531 shares and 210,044 shares attributable to stock-based awards for the three months ended March 31, 2012 and 2011 , 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.

9. PROVISION FOR 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.

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. The Company limits the deferred tax assets recognized related to certain highly-paid officers of the Company to amounts that it estimates will be deductible in future periods based upon the provisions of the 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, 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 March 31, 2012 , the Company continues to maintain a valuation allowance on a portion of 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. The Company also maintains a valuation allowance with respect to certain of its deferred tax assets relating primarily to tax credits in certain non-U.S. jurisdictions.

Income tax expense includes a provision for federal, state and foreign taxes based on the annual estimated effective tax rate applicable to the Company and its subsidiaries, adjusted for certain discrete items which are fully recognized in the period they occur. The Company's effective tax rates for the three months ended March 31, 2012 was 20.1% . The difference between the expected statutory rate of 35% and the Company's effective tax rate for the three months ended March 31, 2012 was primarily due to the beneficial impact of the geographic distribution of the Company's world-wide earnings. The difference between the expected statutory rate of 35% and the Company's effective tax rate of 18.7% for the three months ended March 31, 2011 , was primarily due to the beneficial impact of the geographic distribution of the Company's world-wide earnings and the beneficial impact of the research and experimentation tax credit.

Although the Company files U.S. federal, U.S. state, and foreign tax returns, its major tax jurisdiction is the U.S. In the quarter ended March 31, 2011, the IRS informed the Company that the IRS intends to propose material adjustments to the Company's taxable income for fiscal years 2003 through 2006 related to the Company's intercompany research and development cost-sharing arrangement and related issues. In December 2011, the Company received an addendum to the notice of proposed adjustments from the IRS related to the Company's intercompany research and development cost sharing arrangement. The Company believes that the IRS position is without merit and intends to defend its tax return position vigorously. The fiscal years 2007 through 2009 are also under audit by the IRS.

Determining the consolidated provision for income tax expense, income tax liabilities and deferred tax assets and liabilities involves judgment. The Company calculates and provides for income taxes in each of the tax jurisdictions in which it operates, which involves estimating current tax exposures as well as making judgments regarding the recoverability of deferred tax assets in each jurisdiction. The estimates used could differ from actual results, which may have a significant impact on operating results in future periods.

10. 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 March 31, 2012 . 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.

11. COMMITMENTS:

Supplier Agreements

The Company purchases wafers through purchase orders from its foundries. All but one of the Company's wafer agreements were executed in U.S. currency. Until June 2011, this one foundry required wafer purchases to be in Japanese yen; however, the purchase price within this agreement was fixed at a base rate and allowed for some sharing of the impact of exchange rate fluctuations from the base rate. The currency fluctuation experienced between the time invoices were submitted to the Company until the time the yen was purchased and remitted to the supplier was a financial responsibility of the Company. The Company accounted for the gain or loss related to the payment of these transactions as part of other income or expense. The Company has renegotiated its supply agreement with this foundry to purchase wafers in U.S. currency.

Two of the Company's major suppliers have wafer supply agreements based in U.S. dollars; however, the agreements with these foundries also allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. Each year, the Company's 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 the Company and each of these suppliers.

12. LEGAL PROCEEDINGS AND CONTINGENCIES:

From time to time in the ordinary course of business, the Company becomes involved in lawsuits, or customers and distributors may make claims against the Company. In accordance with ASC 450-10, the Company makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

On October 20, 2004, the Company filed a complaint against Fairchild Semiconductor International, Inc. and Fairchild Semiconductor Corporation (referred to collectively as "Fairchild") in the United States District Court for the District of Delaware. In its complaint, the Company alleged that Fairchild has and is infringing four of Power Integrations' patents pertaining to PWM integrated circuit devices. Fairchild denied infringement and asked for a declaration from the court that it does not infringe any Power Integration patent and that the patents are invalid. The Court issued a claim construction order on March 31, 2006 which was favorable to the Company. The Court set a first trial on the issues of infringement, willfulness and damages for October 2, 2006. At the close of the first trial, on October 10, 2006, the jury returned a verdict in favor of the Company finding all asserted claims of all four patents-in-suit to be willfully infringed by Fairchild and awarding $34.0 million in damages. Although the jury awarded damages, at this stage of the proceedings the Company cannot state the amount, if any, which it might ultimately recover from Fairchild, and no benefits have been recorded in the Company's consolidated financial statements as a result of the damages award. Fairchild also raised defenses contending that the asserted patents are invalid or unenforceable, and the court held a second trial on these issues beginning on September 17, 2007. On September 21, 2007, the jury returned a verdict in the Company's favor, affirming the validity of the asserted claims of all four patents-in-suit. Fairchild submitted further materials on the issue of enforceability along with various other post-trial motions, and the Company filed post-trial motions seeking a permanent injunction and increased damages and attorneys' fees, among other things. On September 24, 2008, the Court denied Fairchild's motion regarding enforceability and ruled that all four patents are enforceable. On December 12, 2008, the Court ruled on the remaining post-trial motions, including granting a permanent injunction, reducing the damages award to $6.1 million , granting Fairchild a new trial on the issue of willful infringement in view of an intervening change in the law, and denying the Company's motion for increased damages and attorneys' fees with leave to renew the motion after the resolution of the issue of willful infringement. On December 22, 2008, at Fairchild's request, the Court temporarily stayed the permanent injunction for 90 days to permit Fairchild to petition the Federal Circuit Court of Appeals for a further stay. On January 12, 2009, Fairchild filed a notice of appeal challenging the Court's refusal to enter a more permanent stay of the injunction, and Fairchild filed additional motions requesting that both the Federal Circuit and the District Court extend the stay of injunction. The District Court temporarily extended the stay pending the Federal Circuit ruling on Fairchild's pending motion, but the Federal Circuit dismissed Fairchild's appeal and denied its motion on May 5, 2009, and the District Court issued an order on May 13, 2009 confirming the reinstatement of the permanent injunction as originally entered in December 2008. On June 22, 2009, the Court held a brief bench re-trial on the issue of willful infringement, and the parties completed post-trial briefing on the issue of willfulness shortly thereafter. On July 22, 2010, the Court found that Fairchild willfully infringed all four of the asserted patents. The Court also invited briefing on enhanced damages and attorneys' fees, and Fairchild filed a motion requesting that the Court amend its findings regarding willfulness. On January 18, 2011, the Court denied Fairchild's request to amend the findings regarding Fairchild's willful infringement and doubled the damages award against Fairchild but declined to award attorneys' fees. On February 3, 2011, the Court entered final judgment in favor of the Company for a total damages award of $12.9 million . Fairchild filed a notice of appeal challenging the final judgment and a number of the underlying rulings, and the Company filed a cross-appeal seeking to increase the damages award. Briefing on the appeal is complete, and the appeal was argued on January 11, 2012. A ruling is expected later this year.

On May 9, 2005, the Company filed a Complaint with the U.S. International Trade Commission (“ITC”) under section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. section 1337 against System General (“SG”). The Company filed a supplement to the complaint on May 24, 2005. The Company alleged infringement of its patents pertaining to pulse width modulation (“PWM”) integrated circuit devices produced by SG, which are used in power conversion applications such as power supplies for computer monitors. The Commission instituted an investigation on June 8, 2005 in response to the Company's complaint. SG filed a response to the ITC complaint asserting that the patents-in-suit were invalid and not infringed. The Company subsequently and voluntarily narrowed the number of patents and claims in suit, which proceeded to a hearing. The hearing on the investigation was held before the Administrative Law Judge (“ALJ”) from January 18 to January 24, 2006. Post-hearing briefs were submitted and briefing concluded February 24, 2006. The ALJ's initial determination was issued on May 15, 2006. The ALJ found all remaining asserted claims valid and infringed, and recommended the exclusion of the infringing products as well as certain downstream products that contain the infringing products. After further briefing, on June 30, 2006 the Commission decided not to review the initial determination on liability, but did invite briefs on remedy, bonding and the public interest. On August 11, 2006 the Commission issued an order excluding from entry into the United States the infringing SG PWM chips, and any LCD computer monitors, AC printer adapters and sample/demonstration circuit boards containing an infringing SG chip. The U.S. Customs Service is authorized to enforce the exclusion order. On October 11, 2006, the presidential review period expired without any action from the President, and the ITC exclusion order is now in full effect. SG appealed the ITC decision, and on November 19, 2007, the Federal Circuit affirmed the ITC's findings in all respects. On October 27, 2008, SG filed a petition to modify the exclusion order in view of a recent Federal Circuit opinion in an unrelated case, and the Company responded to oppose any modification, but the Commission modified the exclusion order on February 27, 2009. Nevertheless, the exclusion order still prohibits SG and related entities from importing the infringing SG chips and any LCD computer monitors, AC printer adapters, and sample/demonstration circuit boards containing an infringing SG chip.

On May 23, 2008, the Company filed a complaint against Fairchild Semiconductor International, Inc., Fairchild Semiconductor Corporation, and Fairchild's wholly-owned subsidiary System General Corporation in the United States District Court for the District of Delaware. In its complaint, the Company alleged that Fairchild has infringed and is infringing three patents pertaining to power supply controller integrated circuit devices. Fairchild answered the Company's complaint on November 7, 2008, denying infringement and asking for a declaration from the Court that it does not infringe any Power Integrations patent and that the patents are invalid and unenforceable. Fairchild's answer also included counterclaims accusing the Company of infringing three patents pertaining to primary side power conversion integrated circuit devices. Fairchild had earlier brought these same claims in a separate suit against the Company, also in Delaware, which Fairchild dismissed in favor of adding its claims to the Company's already pending suit against Fairchild. The Company has answered Fairchild's counterclaims, denying infringement and asking for a declaration from the Court that it does not infringe any Fairchild patent and that the Fairchild patents are invalid. Fairchild also filed a motion to stay the case, but the Court denied that motion on December 19, 2008. On March 5, 2009, Fairchild filed a motion for summary judgment to preclude any recovery for post-verdict sales of parts found to infringe in the parties' other ongoing litigation, described above, and the Company filed its opposition and a cross-motion to preclude Fairchild from re-litigating the issues of infringement and damages for those same products. On June 26, 2009, the Court held a hearing on the parties' motions, and on July 9, 2009 the Court issued an order denying the parties' motions but staying proceedings with respect to the products that were found to infringe and which are subject to the injunction in the other Delaware case between the parties pending the entry of final judgment in that case; the remainder of the case is proceeding. On December 18, 2009, the Court issued an order construing certain terms in the asserted claims of the Company's and Fairchild's patents in suit. Following the Court's ruling on claim construction, Fairchild withdrew its claim related to one of its patents and significantly reduced the number of claims asserted for the remaining two patents. The parties thereafter filed and argued a number of motions for summary judgment, and the Court denied the majority of the parties' motions but granted the Company's motion to preclude Fairchild from re-arguing validity positions that were rejected in the prior case between the parties. Because the assigned Judge retired at the end of July 2010, the case was re-assigned to a different Judge, and the Court vacated the trial schedule and had the parties provide their input on the appropriate course of action. The Court thereafter set a trial schedule with the jury trial on infringement and validity to begin in July 2011. On February 10, 2011, the Court issued an order maintaining the stay with respect to the products that were found to infringe and which are subject to the injunction in the other Delaware case pending the appeal in that case. On April 18, 2011, the Court rescheduled the trial to begin in January 2012, and on June 2, 2011 the Court moved the trial date to permit the parties to address another patent the Company has accused Fairchild of infringing. Following a trial in April 2012, the jury returned a verdict finding that Fairchild infringes two of the Company's patents, that Fairchild has induced others to infringe the Company's patents, and also upheld the validity of the infringed patents. Of the two remaining counterclaim patents Fairchild asserted in the case, one was found not to be infringed, but the jury found the second patent to be infringed by a limited number of the Company's products, although the jury further found the Company did not induce infringement by any customers, including customers outside the United States. The Company is challenging the validity and enforceability of that patent in post-trial proceedings, issues to be decided by the judge overseeing the case. Nevertheless, the Company estimates that even if the verdict on Fairchild's patent were ultimately upheld, the sales potentially impacted up to only about 0.1% of the Company's revenues. The Company will also seek an injunction preventing further infringement of its own patents and is seeking financial damages, as well as enhanced damages for willful infringement, issues to be decided in separate proceedings at a later date.

On June 28, 2004, the Company filed a complaint for patent infringement in the U.S. District Court, Northern District of California, against SG Corporation, a Taiwanese company, and its U.S. subsidiary. The Company's complaint alleged that certain integrated circuits produced by SG infringed and continue to infringe certain of its patents. On June 10, 2005, in response to the initiation of the International Trade Commission (ITC) investigation discussed above, the District Court stayed all proceedings. Subsequent to the completion of the ITC proceedings, the District Court temporarily lifted the stay and scheduled a case management conference. On December 6, 2006, SG filed a notice of appeal of the ITC decision as discussed above. In response, and by agreement of the parties, the District Court vacated the scheduled case management conference and renewed the stay of proceedings pending the outcome of the Federal Circuit appeal of the ITC determination. On November 19, 2007, the Federal Circuit affirmed the ITC's findings in all respects, and SG did not file a petition for review. The parties subsequently filed a motion to dismiss the District Court case without prejudice. On November 4, 2009, the Company re-filed its complaint for patent infringement against SG and its parent corporations, Fairchild Semiconductor International, Inc. and Fairchild Semiconductor Corporation, to address their continued infringement of patents at issue in the original suit that recently emerged from SG requested reexamination proceedings before the U.S. Patent and Trademark Office (USPTO). The Company seeks, among other things, an order enjoining Fairchild and SG from infringing the Company's patents and an award of damages resulting from the alleged infringement. Fairchild has denied infringement and asked for a declaration from the Court that it does not infringe any Power Integrations patent, that the patents are invalid, and that one of the two patents now at issue in the case is unenforceable. On May 5, 2010, Fairchild and SG filed an amended answer including counterclaims accusing the Company of infringing two patents; the Company contests these new claims vigorously, and since that time Fairchild has withdrawn its claim for infringement of one of the patents it asserted against the Company, leaving just one Fairchild patent in the case. The Court held a claim construction hearing on March 24, 2011 and issued a first claim construction order regarding the Company's asserted patents on July 13, 2011 and a second claim construction order regarding Fairchild's asserted patent on August 30, 2011. Discovery is currently under way.

In February 2010, Fairchild and System General (“SG”) filed suits for patent infringement against the Company, Power Integrations Netherlands B.V., and representative offices of Power Integrations Netherlands in Shanghai and Shenzhen with the Suzhou Intermediate Court in the People's Republic of China. The suits assert four Chinese patents and seek an injunction and damages of approximately $19.0 million . Power Integrations Netherlands filed invalidation proceedings for all four asserted SG patents in the People's Republic of China Patent Reexamination Board (PRB) of the State Intellectual Property Office (SIPO), and all four challenges were accepted by the PRB, with hearings conducted in September 2010. Early this January, the Company received rulings from the PRB invalidating the majority of the claims Fairchild asserted in litigation. The Suzhou Court thereafter conducted evidentiary hearings, and the parties are following up, with no trial date set at this time. The Company believes the Fairchild and SG claims discussed above are without merit and intends to contest them vigorously.

On July 11, 2011, the Company filed a complaint in the U.S. District Court, District of Columbia, against David Kappos in his capacity as Director of the United States Patent and Trademark Office (“PTO”) as part of the ongoing reexamination proceedings related to one of the patents asserted against Fairchild and SG in the Delaware litigation described above. The Company filed a motion for summary judgment on a preliminary jurisdictional issue, and the PTO filed a cross-motion to dismiss on this same issue; briefing on these motions is now complete, with a ruling expected in the coming months. No schedule has been set for the case.

On May 1, 2012, Fairchild Semiconductor Corporation and Fairchild's wholly-owned subsidiary, System General Corporation (referred to collectively as “Fairchild”), filed a complaint against the Company in the United States District Court for the District of Delaware. In its complaint, Fairchild alleges that the Company has and is infringing four patents pertaining to power conversion integrated circuit devices. The Company has not yet answered Fairchild's complaint.

The Company is unable to predict the outcome of legal proceedings with certainty, and there can be no assurance that Power Integrations will prevail in the above-mentioned unsettled litigations. These litigations, whether or not determined in Power Integrations' favor or settled, will be costly and will divert the efforts and attention of the Company's management and technical personnel from normal business operations, potentially causing a material adverse effect on the business, financial condition and operating results. Currently, the Company is not able to estimate a loss or a range of loss for the ongoing litigation disclosed above, however adverse determinations in litigation could result in monetary losses, the loss of proprietary rights, subject the Company to significant liabilities, require Power Integrations to seek licenses from third parties or prevent the Company from licensing the technology, any of which could have a material adverse effect on the Company's business, financial condition and operating results.

In the quarter ended March 31, 2011, the IRS informed the Company that the IRS intends to propose material adjustments to the Company's taxable income for the years 2003 through 2006 related to the Company's intercompany research and development cost-sharing arrangement and related issues and in December 2011, the Company received an addendum to the notice of proposed adjustments from the IRS related to the Company's intercompany research and development cost sharing arrangement (refer to Note 9, *Provision for Income Tax* , for further details). The Company believes that the IRS position is without merit and intends to defend its tax return position vigorously.

13. RECENT ACCOUNTING PRONOUNCEMENTS:

On January 1, 2012, the Company adopted the following accounting pronouncements:

In May 2011, the Financial Accounting Standards Board (FASB) issued amendments to the FASB Accounting Standard Codification (ASC) relating to fair value measurements, Accounting Standards Update (ASU) 2011-04, *Fair Value Measurement,* ASC Topic 820. The amendments clarify the application of existing fair value measurement requirements and results in common measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). The Company applied these amendments in the first quarter of fiscal 2012.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (* ASC Topic 220). This amendment gives an entity two options to present the total of comprehensive income, the components of net income, and the components of other comprehensive income. An entity can elect to present comprehensive income in either (1) a single continuous statement of comprehensive income, or (2) in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The Company adopted this amendment beginning in the first quarter of 2012.

In September 2011, the FASB issued ASU No. 2011-08, *Testing Goodwill for Impairment,* (ASC Topic 350). Under the amendments in this ASU, an entity has 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, after assessing the totality of events or circumstances, an entity determines 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. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss, if any. Under the amendments in this ASU, an entity also has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period.

14. ACQUISITION:

On March 30, 2012, the Company through its subsidiaries entered into a definitive agreement to acquire CT-Concept Technologie AG ("Concept"), a Swiss company, by acquiring all of the outstanding shares of its Swiss parent companies, Concept Beteiligungen AG and CT-Concept Holding AG, for approximately $115.8 million , net of assumed cash. The Company closed the acquisition on May 1, 2012. Pursuant to the purchase agreement, the purchase price is subject to a net asset value adjustment which will be determined after the closing date, and is limited to a maximum of approximately $7.7 million . The net asset value adjustment will be paid within approximately six months after May 1, 2012.

Concept produces highly integrated driver systems for insulated-gate bipolar transistors, or IGBT modules, replacing discrete solutions and other alternatives by offering an increased level of integration, reliability and energy efficiency. Concept products are used in power-conversion circuitry for applications ranging up to a gigawatt of output, including industrial motor drives, solar and wind power systems, electric trains and trams, electric cars, and medical equipment. The Company expects to include revenues from Concept principally in its industrial end-market category.

The Company has not made all of the remaining disclosures required by ASC805-10-50-2, *Business Combinations,* as the acquisition has only recently closed. The Company is therefore currently in the process of completing the purchase accounting for the acquisition.

15. INVESTMENT IN THIRD PARTY:

On October 22, 2010, the Company made a $7.0 million investment in preferred stock of a privately held company, SemiSouth Laboratories (“SemiSouth”). Also in October 2010, the Company paid $10.0 million as a prepaid royalty in exchange for the right to use SemiSouth's technology. The Company will amortize the royalty to cost of revenues based on the Company's sales of products incorporating the licensed technology. The Company classified its investment in SemiSouth, with a carrying value of $7.0 million and prepaid royalty of $10.0 million within Other Assets in the Company's condensed consolidated balance sheet as of March 31, 2012 . The Company does not expect to amortize the prepaid royalty in 2012.

In February 2011, the Company entered into an agreement with SemiSouth to provide a lease line for the financing of capital equipment. Under the terms of the agreement, SemiSouth can borrow up to $8.6 million through January 2013, of which a total of $8.5 million had been funded as of March 31, 2012 . Refer to Note 16, *Lease Line to Third Party* , for details. The Company included the lease line receivable and deposits on equipment in Other Assets and Prepaid Expenses and Other Current Assets in its consolidated balance sheet at March 31, 2012 .

In December 2011, the Company entered into a $2.5 million lease guaranty agreement (the "Guaranty Agreement") with a third party. In accordance with the terms of the Guaranty Agreement, the Company guaranteed up to $2.5 million of SemiSouth's obligations under SemiSouth's equipment lease with such third party. The Guaranty Agreement remained in place until Semisouth secured additional financing, which occurred in March 2012, at which time the Guaranty Agreement was terminated.

The Company's 2010 agreement with SemiSouth provides, among other things, that the Company has the option to acquire SemiSouth in the future (“Call Option”) and that the Company may be obligated to acquire SemiSouth at a future date if SemiSouth achieves certain financial performance conditions (“Put Option”). The Put and Call Options terminate on the date that is approximately a month following delivery to the Company of SemiSouth's financial statements for the quarter ending December 31, 2013.

The Call Option can be exercised by the Company at a multiple of SemiSouth's annualized net operating profits after tax (“NOPAT”) (based on the average of this measure over a period of several months), as defined in the agreement. The multiple is intended to result in an acquisition price equal to the estimated fair value of SemiSouth. The minimum acquisition price would be $36 million , subject to certain adjustments. Pursuant to an amended agreement entered into in March 2012, the maximum purchase price shall not exceed $80.0 million .

The Put Option can only be exercised by SemiSouth once certain revenue and profit metrics have been reached. At that time, SemiSouth could obligate the Company to acquire SemiSouth at a multiple of SemiSouth's NOPAT. The multiple is intended to result in an acquisition price equal to the estimated fair value of SemiSouth limited to a maximum of $80.0 million pursuant to the March 2012 amendment. In order to reach the revenue and profit metrics required to exercise the Put Option, SemiSouth would need to increase its quarterly revenue to approximately 15 times the level of revenues achieved in the first quarter of 2012.

The NOPAT multiple was determined to reflect fair value based on the Market Approach using Level 2 inputs that are derived principally from observable market data by comparing multiples for similar publicly traded companies. Due to the fact that the strike price of the Put Option is continually being adjusted to reflect the changes in the fair value of SemiSouth, the fair value of the Put Option was determined to be zero .

In July 2011, SemiSouth obtained $15 million of financing through the sale, and concurrent licensing back, of its intellectual property ("IP") with a financing company. In connection with this arrangement, the Company entered into a contingent purchase commitment with the financing company for SemiSouth's IP. The contingent purchase commitment requires the Company to purchase the IP previously owned by SemiSouth from its new owner for $15 million (plus reimbursement of certain expenses) under certain conditions generally relating to SemiSouth's failure to make certain payments or SemiSouth's insolvency. In this event, the agreement sets forth a process to be followed before the Company's purchase commitment matures. First, the agreement allows the Company to exercise its Call Option for a certain period of time and under certain conditions. If the Company does not initially exercise its Call Option, then SemiSouth can be sold to a third party during a period of time of up to approximately half a year (which period of time may be shortened by the new SemiSouth IP owner) or the Company could still exercise its Call Option. After that period of time elapses, the Company is obligated to purchase the SemiSouth IP for $15 million (plus reimbursement of certain expenses). The Company provided a $15 million letter of credit in August 2011 to the financing company to secure the contingent purchase commitment.

The Company entered into a contract in July 2011 with SemiSouth to act as a sales representative for SemiSouth. The sales representation agreement will allow the Company to earn a fee for its efforts in representing, promoting and soliciting orders for SemiSouth products. The contract can be terminated with or without cause by giving prior written notice to the other party.

In March 2012, the Company loaned SemiSouth $18.0 million , and in exchange the Company was issued a promissory note. In consideration for the loan the Company obtained an amendment to its 2010 agreement with SemiSouth to

POWER INTEGRATIONS, INC.

NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

establish a maximum purchase price related to both the Company's option to acquire SemiSouth ("Purchase Option") and its potential obligation to acquire SemiSouth (as discussed above). The Company used Level 3 inputs in its fair-market valuation utilizing the income-approach valuation technique. The Company prepared a discounted cash flow analysis using the following unobservable inputs: weighted average cost of capital, long-term revenue growth, control premium, and discount for lack of marketability. The Company then used a Black-Scholes option pricing model to determine the fair value of the Company's purchase option to be approximately $6.2 million . The Company's valuation technique derived inputs principally from market data (i.e., correlation values). The Company accounted for the $18.0 million promissory note in the Other Assets caption in its condensed consolidated balance sheet, net of the $6.2 million interest discount related to the Purchase Option, of which $0.2 million was amortized as of March 31, 2012. The interest discount will be amortized to interest income over the life of the promissory note. The amortization of the interest income and the stated interest rate on the promissory note reflect the approximate fair value of the effective interest rate. The Company also recorded the corresponding $6.2 million value of the Purchase Option in Other Assets in its condensed consolidated balance sheet. The following table reflects the Company's interest income related to its SemiSouth agreements (in thousands):

	Three Months Ended March 31,	
	2012	2011
Interest income on note from SemiSouth	$ 24	$ —
Non-cash interest income on note from SemiSouth	157	—
Interest income from SemiSouth lease line	83	21
Total interest income from SemiSouth	$ 264	$ 21

The Company's investment in SemiSouth is periodically reviewed for other-than-temporary declines in fair value by considering available evidence, including general market conditions, SemiSouth's financial condition, pricing in recent rounds of financing, earnings and cash flow forecasts, recent operational performance and any other readily available market data.

The Company has determined that its investment in SemiSouth, in which the Company holds less than 20% equity interest, is a variable interest entity ("VIE") in which the Company is not the primary beneficiary. The primary factors in the Company's assessment were; (i) SemiSouth's management team and board of directors were solely responsible for all business and financial decisions for SemiSouth and (ii) the Company does not have the ability to direct the activities that significantly impact the economic performance of SemiSouth. The Company accounts for its non-marketable investment in SemiSouth under the cost method.

The Company's maximum exposure to loss as a result of its interest in SemiSouth is limited to the aggregate of the carrying value of its equity investment, up to $8.6 million for the lease line agreement and $18.0 million for the loan to SemiSouth. There were no additional future funding commitments to SemiSouth as of March 31, 2012 .

16. LEASE LINE TO THIRD PARTY:

In February 2011, the Company entered into an agreement with SemiSouth to provide a lease line for the financing of capital equipment. Under the term of the agreement, SemiSouth can borrow up to $8.6 million through January 2013. As of March 31, 2012 , a total of $8.5 million had been funded, consisting of: $8.2 million funded, less payments withheld under this lease arrangement to finance capital equipment commencing in February 2011; and $0.3 million paid as deposits on equipment which the Company will lease to SemiSouth upon delivery of such equipment. The Company included the lease line receivable and deposits on equipment in Other Assets and Prepaid Expenses and Other Current Assets in its condensed consolidated balance sheet at March 31, 2012 . The total lease payments related to the $8.2 million funded, including interest, will be received over a four-to-eight year term and are reflected in the table below (in millions):

POWER INTEGRATIONS, INC.

NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fiscal Year	Total Minimum Lease Payments
2012 (remaining 9 months)	$ 0.9
2013	1.2
2014	1.2
2015	1.2
2016	1.2
Thereafter	3.0
Total	$ 8.7

The Company assessed the credit worthiness of SemiSouth at the inception of the lease line, and is monitoring their credit quality on an ongoing basis. If the credit worthiness of SemiSouth diminishes the Company will establish a specific reserve against the lease line receivable at that time.

17. BANK LINE OF CREDIT:

In February 2011, the Company entered into an unsecured credit agreement with a bank (the “Credit Agreement”). Pursuant to the Credit Agreement, the Company can request, from time to time until February 2013, advances in an amount not to exceed an aggregate principal amount of $50.0 million . On April 2, 2012 the amount available under this credit agreement was increased to $65.0 million , the proceeds of which can be used for working capital requirements and other general corporate purposes. The agreement also covers advances for commercial letters of credit. At March 31, 2012 , the Company had a $15.0 million outstanding letter of credit in connection with the contingent purchase commitment (referred to in Note 15, *Investment in Third Party*). The terms of this credit agreement require the Company to remain in compliance with certain financial and other covenants, which the Company is currently in compliance with. As of March 31, 2012 there were no advances drawn against this credit line.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the notes to those statements included elsewhere in this Quarterly Report on Form 10-Q, and with consolidated financial statements and management's discussion and analysis of our financial condition and results of operations in our Annual Report on Form 10-K for the year ended December 31, 2011, filed with the SEC on February 29, 2012. 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 II, Item 1A-“Risk Factors” and elsewhere in this report.

Overview

We design, develop, manufacture and market high-voltage, analog and mixed-signal integrated circuits, or ICs, and high-voltage diodes for use in electronic power supplies, also known as switched-mode power supplies. Our ICs and diodes are used principally in AC-DC power supplies in a wide variety of end products, primarily in the consumer, communications, computer and industrial electronics markets. For example, our ICs are commonly used in such end products as mobile-phone chargers, desktop computers, home entertainment equipment, appliances, utility meters and LED light bulbs and fixtures.

We believe that our products enable power supplies that are superior to those designed with alternative technologies. We differentiate our ICs through innovation aimed at helping our customers meet the desired performance specifications for their power supplies, including increasingly stringent energy-efficiency requirements, while minimizing complexity, component count, time-to-market and overall system cost. We invest significant resources in research and development in an effort to achieve this differentiation.

While the size of the power-supply market fluctuates with changes in macroeconomic conditions, the market has generally exhibited a modest growth rate over time as growth in the unit volumes of power supplies has largely been offset by reductions in the average selling price of components in this market. Therefore, the growth of our business depends primarily on our penetration of the power supply market, and our success in expanding the addressable market by introducing new products that address a wider range of applications. Our growth strategy includes the following elements:

- *Increase the penetration of our ICs in the “low-power” AC-DC power supply market.* The vast majority of our revenues come from power-supply applications requiring 50 watts of output or less. We continue to introduce more advanced products that make our IC-based solutions more attractive in this market. We have also increased the size of our sales and field-engineering staff considerably in recent years, and we continue to expand our offerings of technical documentation and design-support tools and services in order to help customers use our ICs. These tools and services include our *PI Expert*™ design software, which we offer free of charge, and our transformer-sample service.

- *Capitalize on the growing demand for more energy-efficient electronic products and lighting technologies.* We believe that energy-efficiency is becoming an increasingly important design criterion for power supplies due largely to the emergence of standards and specifications that encourage, and in some cases mandate, the design of more energy-efficient electronic products. While power supplies built with competing technologies are often unable to meet these standards cost-effectively, power supplies incorporating our ICs are generally able to comply with all known efficiency specifications currently in effect.

  Additionally, technological advances combined with regulatory and legislative actions are resulting in the adoption of alternative lighting technologies such as light-emitting diodes, or LED. We believe this presents a significant opportunity for us because our ICs are used in power-supply, or driver, circuitry for high-voltage LED lighting applications.

- *Increase the penetration of our products in “high-power” applications.* We believe we have developed and acquired new technologies and products that enable us to bring the benefits of highly integrated power supplies to applications ranging from 50 to about 500 watts of output. These include such applications as main power supplies for flat-panel TVs and desktop PCs, as well as power supplies for LED streetlights, game consoles, and notebook computers, among others.

Beginning May 1, 2012, with the completion of our acquisition of CT-Concept Technologie AG (“Concept”), we have expanded our range of addressable power-conversion applications to include power levels up to a gigawatt. Concept produces highly integrated driver systems for IGBT modules, replacing discrete solutions and other alternatives by offering an increased level of integration, reliability and energy efficiency. Concept products are used in power conversion circuitry for industrial motor drives, solar and wind power systems, electric trains and trams, electric cars, and medical equipment.

Our quarterly operating results are difficult to predict and subject to significant fluctuations. We plan our production and inventory levels based on internal forecasts of projected customer demand, which is highly unpredictable and can fluctuate substantially. Customers typically may cancel or reschedule orders on short notice without significant penalty and, conversely, often place orders with very short lead times to delivery. Also, external factors such as global economic conditions and supply-chain dynamics can cause our operating results to be volatile.

Our net revenues were $71.8 million in the three months ended March 31, 2012, compared to $76.8 million in the same period of 2011. The decrease was driven by lower sales of our products into the communications, industrial and computer end markets, reflecting demand trends generally observed across the broader semiconductor industry.

Our top ten customers, including distributors that resell our products to OEMs and merchant power supply manufacturers, accounted for 66% of our net revenues in the three months ended March 31, 2012, compared to 67% in the same period in 2011. Our top two customers, both distributors of our products, collectively accounted for approximately 32% of our net revenues in the three months ended March 31, 2012. In the first quarter of 2011, our top two customers, both distributors of our products, collectively accounted for approximately 31% of our net revenues. International sales accounted for 96% of our net revenues in the three months ended March 31, 2012 and in 2011.

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 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. Changes in the prices of raw materials used in our products, such as copper and gold, can also affect our gross margin. 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 margin was 48% of net revenues in the three months ended March 31, 2012, compared with 47% of net revenues in the corresponding period of 2011. We have negotiated more favorable wafer pricing with our foundries which resulted in a decrease in the cost of silicon wafers purchased from our wafer fabrication foundries in the first quarter of 2012 compared to the same period of 2011. This factor was partially offset by higher overhead costs resulting from lower production volumes in the first quarter of 2012 compared to the same period in 2011. While we cannot necessarily predict the future direction of our gross margin because many of the factors influencing it are outside of our control, we expect our gross margin to improve in the second quarter of 2012 relative to the first quarter as a result of further product-cost improvements.

Total operating expenses in the three months ended March 31, 2012 were $25.9 million, compared to $24.7 million in the same period in 2011. The increase was driven primarily by increased research and development expenses, primarily payroll and related expenses due to increased headcount and increased product development expenses. In addition, general and administrative expenses increased in connection with our acquisition of Concept. (Refer to Note 14, *Acquisition* , in our Notes to Condensed Consolidated Financial Statements for recent activity.)

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 (“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; 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 Condensed Consolidated Financial Statements.

Revenue recognition

Product revenues consist of sales to original equipment manufacturers, or OEMs, merchant power supply manufacturers and distributo rs. Approximately 71% of our net produ ct sales were made to distributors in the first quarter of 2012, and in the twelve months ended December 31, 2011. 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 requires letters of credit whenever deemed necessary.

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. 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. 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 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 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 March 31, 2012 and December 31, 2011 was approximately $18.9 million and $16.7 million , respectively. The total deferred cost as of March 31, 2012 and December 31, 2011 was approximately $9.5 million and $8.8 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 us to adjust the distributor's cost from the standard price to the pre-approved lower price. After we verify the claim, a credit memo is issued to the distributor for the ship and debit claim. We maintain a reserve for unprocessed claims and future ship and debit price adjustments. The reserve appears as a reduction to accounts receivable 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.

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 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 cost to recognize. Changes in these estimates could result in changes to our compensation charges.

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.

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 certain 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 March 31, 2012, we continue to maintain a valuation allowance on a portion of 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 some non-U.S. jurisdictions.

In the first quarter of 2011, the IRS informed us that it intends to propose material adjustments to our taxable income for fiscal years 2003 through 2006 related to our intercompany research and development cost-sharing arrangement and related issues. In December 2011, we received an addendum to the notice of proposed adjustments from the IRS related to our intercompany research and development cost sharing arrangement. We believe the IRS's position with respect to the proposed adjustment is inconsistent with applicable tax law, and that we have a meritorious defense to our position. Accordingly, we intend to continue to challenge the IRS's position on this matter vigorously. While we believe the IRS's asserted position on this matter is not supported by applicable law, we have provided reserves for our position in this matter, and we may be required to make payments to the IRS pending resolution. If this matter is litigated and the IRS is able to successfully sustain its position, our results of operations and financial condition could be materially and adversely affected (refer to Note 9, *Provision for Income Taxes* , in our Notes to Consolidated Financial Statements for further details). Resolution of this matter is not anticipated within the next year.

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 this ASC, 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, after assessing the totality of events or circumstances, an entity determines 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 evaluated goodwill for impairment in the fourth quarter 2011, and concluded that no impairment existed as of December 31, 2011. Additionally, no impairment indicators have been identified during the three months ended March 31, 2012 .

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 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 certain operating data as a percentage of net revenues for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
Net revenues	100.0%	100.0%
Cost of revenues	51.8	52.6
Gross profit	48.2	47.4
Operating expenses:		
Research and development	14.8	13.1
Sales and marketing	11.3	10.7
General and administrative	9.9	8.4
Total operating expenses	36.0	32.2
Income from operations	12.2	15.2
Other income, net	0.9	0.6
Income before provision for income taxes	13.1	15.8
Provision for income taxes	2.6	3.0
Net income	10.5%	12.8%

Comparison of the Three Months Ended March 31, 2012 and 2011

Net revenues. Net revenues consist of revenues from product sales, which are calculated net of returns and allowances. Net revenues for the three months ended March 31, 2012 were $71.8 million compared with $76.8 million for the three months ended March 31, 2011, a decrease of approximately 6%. The decrease in revenues was driven primarily by lower sales of our products into the communications, industrial and computer end markets, reflecting demand trends generally observed across the broader semiconductor industry.

Our net revenue mix by product family and by end market for the three months ended March 31, 2012 , compared to the three months ended March 31, 2011 , were as follows:

Product Family	Three Months Ended March 31, 2012	2011
LinkSwitch	41%	40%
TinySwitch	33%	35%
TOPSwitch	23%	23%
Other	3%	2%

End Market	Three Months Ended March 31, 2012	2011
Consumer	40%	37%
Communications	27%	32%
Industrial	21%	20%
Computer	12%	11%

International sales, consisted of sales outside of the Americas based on "ship to" customer locations, were $68.7 and $73.5 million in the three months ended March 31, 2012 and 2011, respectively. This represented 96% of net revenues in both the three months ended March 31, 2012 and 2011. Although the power supplies using our products are distributed to end markets worldwide, most of these power supplies are manufactured in Asia. As a result, sales to this region represented 84% of our net revenues for both the three months ended March 31, 2012 and 2011. We expect international sales, and sales to the Asia region in particular, to continue to account for a large portion of our net revenues in the future.

Sales through distributors accounted for 71% and 68% of net revenues in the three months ended March 31, 2012, and 2011, respectively, with direct sales to OEMs and power supply manufactures accounting for the remainder.

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

Customer	Three Months Ended March 31, 2012	2011
A	20%	19%
B	12%	12%

Customers A and B are distributors of our products. No other customers accounted for 10% or more of our net revenues in those periods.

Gross profit. Gross profit is net revenues less cost of revenues. Our cost of revenues consists primarily of costs associated with the purchase of wafers from our foundries, the assembly, packaging and testing of our products by sub-contractors, product testing performed in our own facility, and overhead associated with the management of our supply chain. Gross margin is gross profit divided by net revenues. The table below compares gross profit and gross margin for the three months ended March 31, 2012 and 2011 (dollars in millions):

	Three Months Ended March 31, 2012	2011
Net revenues	$71.8	$76.8
Gross profit	$34.6	$36.4
Gross margin	48.2%	47.4%

The increase in gross margin for the three months ended March 31, 2012, compared with the same period in the prior year, was due primarily to lower manufacturing costs. We have negotiated more favorable wafer pricing with our foundries for 2012, resulting in a decrease in the cost of silicon wafers purchased from our wafer fabrication foundries in the first quarter of

2012, compared to the same period of 2011. This factor was partially offset by higher overhead costs resulting from lower production volumes in the first quarter of 2012 compared to the same period in 2011.

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 until such products are released to production. The table below compares R&D expenses for the three months ended March 31, 2012 and 2011 (dollars in millions):

	Three Months Ended March 31,	
	2012	**2011**
Net revenues	$71.8	$76.8
R&D expenses	$10.6	$10.0
R&D expenses as a % of net revenue	14.8%	13.1%

R&D expenses increased in the three months ended March 31, 2012, compared to the same period in 2011, driven primarily by increased payroll and related expenses, including stock-based compensation expense, resulting from increased headcount. Product-development expenses also increased for the three month period ended March 31, 2012, compared to the same period in 2011, due to expenses related to foundry qualifications and ongoing new-product development.

Sales and marketing expenses. Sales and marketing expenses consist primarily of employee-related expenses, including stock-based compensation, commissions to sales representatives, and facilities expenses, including expenses associated with our regional sales and support offices. The table below compares sales and marketing expenses for the three months ended March 31, 2012 and 2011 (dollars in millions):

	Three Months Ended March 31,	
	2012	**2011**
Net revenues	$71.8	$76.8
Sales and marketing expenses	$8.1	$8.2
Sales and marketing expenses as a % of net revenue	11.3%	10.7%

The decrease in sales and marketing expenses in the three months ended March 31, 2012 compared to the same period of 2011 was driven primarily by decreased expenses related to marketing materials, partially offset by increased payroll and related expenses, including stock-based compensation expense, and sales infrastructure expenses as a result of increased headcount to expand our international sales force.

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 three months ended March 31, 2012 and 2011 (dollars in millions):

	Three Months Ended March 31,	
	2012	**2011**
Net revenues	$71.8	$76.8
G&A expenses	$7.1	$6.5
G&A expenses as a % of net revenue	9.9%	8.4%

G&A expenses increased in the three months ended March 31, 2012 compared to the prior year. The increase was due primarily to acquisition-related expenses in connection with our agreement to acquire Concept. (Refer to Note 14, *Acquisitions* , in our Notes to Condensed Consolidated Financial Statements, for details.)

Other income, net . Other income, net consists primarily of interest income earned on cash and cash equivalents, marketable securities and other investments. The table below compares other income, net for the three months ended March 31, 2012 and 2011 (dollars in millions):

	Three Months Ended March 31,	
	2012	2011
Net revenues	$71.8	$76.8
Other income	$0.6	$0.4
Other income as a % of net revenue	0.9%	0.6%

Other income, net, increased in the three months ended March 31, 2012, compared to the same period in 2011. The increases were related to interest earned on our $18.0 million promissory note with SemiSouth (refer to Note 15, *Investment in Third Party* , in our Notes to Condensed Consolidated Financial Statements, for details), in addition to our lease line to SemiSouth. (Refer to Note 16, *Lease Line to Third Party* , in our Notes to Condensed Consolidated Financial Statements, for details.)

Provision for income taxes . Provision for income taxes represents federal, state and foreign taxes.
The table below compares income tax expenses for the three months ended March 31, 2012 and 2011 (dollars in millions):

	Three Months Ended March 31,	
	2012	2011
Income before provision for income taxes	$9.3	$12.1
Provision for income taxes	$1.9	$2.3
Effective tax rate	20.1%	18.7%

The difference between the expected statutory rate of 35% and our effective tax rate for the three months ended March 31, 2012, was primarily due to the beneficial impact of the geographic distribution of our world-wide earnings. The difference between the expected statutory rate of 35% and our effective tax rate for the three months ended March 31, 2011, was primarily due to the beneficial impact of the geographic distribution of our world-wide earnings and the beneficial impact of a research and experimentation tax credit.

Liquidity and Capital Resources

As of March 31, 2012, we had $214.0 million in cash, cash equivalents and marketable securities, an increase of approximately $1.2 million from $212.8 million as of December 31, 2011. As of March 31, 2012, and December 31, 2011, we had working capital, defined as current assets less current liabilities of $248.2 million and $217.5 million, respectively. The increase in working capital resulted from the reclassification of our long-term marketable securities to short-term in connection with the change in our investment policy; refer to Note 2, *Summary of Significant Accounting Policies,* in our Notes to Condensed Consolidated Financial Statements, for further details.

In February 2011, we entered into an unsecured credit agreement with a bank, which we refer to as the Credit Agreement. Pursuant to the Credit Agreement, we can request, from time to time until February 2013, advances in an amount not to exceed an aggregate principal amount of $50.0 million . On April 2, 2012, the amount available under this credit agreement was increased to $65.0 million , the proceeds of which can be used for working capital requirements and other general corporate purposes. The agreement also covers advances for commercial letters of credit. At March 31, 2012 , we had a $15.0 million outstanding letter of credit in connection with the contingent purchase commitment (referred to in Note 15, *Investment in Third Party*). The terms of this credit agreement require us to remain in compliance with financial and other covenants, with which we are currently in compliance. As of March 31, 2012 there were no advances drawn against this credit line.

Operating activities generated cash of $21.6 million in the three months ended March 31, 2012. Net income for this period was $7.5 million; we also incurred non-cash depreciation, amortization and stock-based compensation expenses of $3.7 million, $0.2 million and $3.0 million, respectively. Additional sources of cash included (1) a $9.2 million decline in inventory due to reduced wafer purchases and stronger-than-expected sales during the quarter (2) a $1.5 million decrease in accounts payable primarily due to the timing of invoice payment processing and (3) a $1.3 million decrease in prepaid expenses resulting primarily from a decrease in prepaid legal fees. These sources of cash were partially offset by a $7.3 million increase in accounts receivable due to higher shipments in March 2012, compared to December 2011.

Our operating activities generated cash of $5.7 million in the three months ended March 31, 2011, driven primarily by (1) net income of $9.9 million, which included the impact of non-cash depreciation, amortization and stock-based compensation expenses totaling $3.7 million, $0.2 million and $2.5 million, respectively, (2) an increase in prepaid expenses and other assets of $1.4 million, due primarily to the amortization of prepaid legal expenses in the first quarter of 2011. These sources of cash were partially offset by; (1) an increase in accounts receivable of $7.6 million, related to increased customer shipments in the first quarter of 2011 compared to the fourth quarter of 2010, (2) a decrease in accounts payable of $2.9 million related to the timing of invoice payment processing, and (3) a decrease in deferred income on sales to distributors of $1.3 million, due primarily to a decrease in our distributor inventory levels compared to the prior quarter, reducing the related deferred revenue.

Our investing activities in the three months ended March 31, 2012 resulted in a $19.5 million net use of cash, consisting of: (1) $7.5 million for purchases of property and equipment, primarily manufacturing equipment to support our growth, and building improvements in connection with our research and development facility in New Jersey; and (2) $18.0 million for the issuance of a Note receivable from SemiSouth (refer to Note 15, *Investment in Third Party* , for further details). These uses of cash were partially offset by $6.1 million of proceeds from maturities of marketable securities. Our investing activities in the three months ended March 31, 2011, resulted in a $29.9 million use of cash, consisting of: (1) $10.2 million of net purchases of marketable securities; (2) $7.2 million for purchases of property and equipment; (3) $6.9 million paid in relation to the acquisition of Qspeed; and (4) $5.6 million in connection with our lease line with SemiSouth.

Our financing activities in the three months ended March 31, 2012, resulted in net cash proceeds of $5.2 million. Financing activities consisted primarily of proceeds of $6.5 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 $1.4 million for the payment of dividends to stockholders. In the three months ended March 31, 2011, we received $6.2 million, net, from financing activities, consisting primarily of $7.3 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 $1.4 million for the payment of dividends to stockholders.

On March 30, 2012, we entered into a definitive share purchase agreement, through our subsidiaries, to acquire Concept, a Swiss company, by acquiring all of the outstanding shares of its Swiss parent companies Concept Beteiligungen AG and CT-Concept Holding AG for approximately $115.8 million, net of assumed cash. We closed the acquisition on May 1, 2012. Pursuant to the purchase agreement, the purchase price is subject to a net asset value adjustment which will be determined after the closing date, and is limited to a maximum of approximately $7.7 million. The net asset value adjustment will be paid within approximately six months after May 1, 2012.

We paid dividends on a quarterly basis in 2011, which resulted in approximately a $1.4 million use of cash per quarter. In January 2012, our board of directors continued the dividend payments by declaring 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 first quarterly dividend payment of approximately $1.4 million was made on March 30, 2012, with subsequent quarterly payments to be approximately the same amount. 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.

As of March 31, 2012 we have a contractual obligation related to income tax, which comprises primarily unrecognized tax benefits of approximately $35.5 million. The tax obligation was classified as long-term income taxes payable and a portion is recorded in deferred tax assets in our condensed consolidated balance sheet. The settlement period for our income tax liabilities cannot be determined; however, they are not expected to be due within the next year.

In the first quarter of 2011, the IRS informed us that it intends to propose material adjustments to our taxable income for fiscal years 2003 through 2006 related to our intercompany research and development cost-sharing arrangement and related issues. In December 2011, we received an addendum to the notice of proposed adjustments from the IRS related to our intercompany research and development cost sharing arrangement. We believe the IRS's position with respect to the proposed adjustment is without merit, inconsistent with applicable tax law, and that we have a meritorious defense to our position. Accordingly, we intend to continue to challenge the IRS's position on this matter vigorously. While we believe the IRS's asserted position on this matter is not supported by applicable law, we may be required to make additional payments to the IRS pending resolution of this matter. If this matter is litigated and the IRS is able to successfully sustain its position, our results of operations and financial condition could be materially and adversely affected. Resolution of this matter is not anticipated within the next year (refer to Note 9, *Provision for Income Taxes* , in our Notes to Condensed Consolidated Financial Statements).

In March 2012, we loaned $18.0 million to SemiSouth, and in exchange we were issued a promissory note. We intend to hold the note to maturity which occurs in March 2014. In connection with the note issuance we amended our 2010 agreement with SemiSouth to include a cap on the purchase price of $80.0 million under the Call and Put Option ("Purchase Option"). We estimated the value of the Purchase Option to be approximately $6.2 million using Level 2 inputs, refer to Note 4, *Fair Value Measurements* , in our Notes to Condensed Consolidated Financial Statements for valuation details. We accounted for the $18.0 million promissory note in Other Assets in our condensed consolidated balance sheet, net of the $6.2 million interest discount related to the Purchase Option. The interest discount will be amortized to interest income over the life of the promissory note. The amortization of the interest discount and the stated interest rate on the promissory note reflects the approximate fair value of the effective interest rate.

There were no other material changes, other than stated in the liquidity section above, outside of the ordinary course of business in our contractual commitments reported in our Annual Report on Form 10-K for the year ended December 31, 2011.

Our existing cash, cash equivalents and investment balances may change during the year due to changes in our planned cash outlays, including changes in incremental costs such as direct and integration costs related to our acquisitions. Our intent is to permanently reinvest our earnings from foreign operations. Current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations since the majority of our cash and investments are held in the U.S. In the event funds from foreign operations are needed to fund operations in the United States and if U.S. tax has not already been previously provided, we would be required to accrue and pay additional U.S. taxes in connection with the repatriation of any funds.

If our operating results deteriorate during the remainder of 2012, 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 credit agreement 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.

Recent Accounting Pronouncements

On January 1, 2012, we adopted the following accounting pronouncements:

In May 2011, the Financial Accounting Standards Board (FASB) issued amendments to the FASB Accounting Standard Codification (ASC) relating to fair value measurements, Accounting Standards Update (ASU) 2011-04, *Fair Value Measurement,* ASC Topic 820. The amendments clarify the application of existing fair value measurement requirements and results in common measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). We adopted these amendments in the first quarter of 2012, and determined that the adoption did not have a material impact on our condensed consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (* ASC Topic 220). This amendment gives an entity two options to present the total of comprehensive income, the components of net income, and the components of other comprehensive income. An entity can elect to present comprehensive income in either (1) a single continuous statement of comprehensive income, or (2) in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. We adopted this amendment in the first quarter of 2012, and will disclose other comprehensive income in a separate but consecutive statement following our condensed consolidated statements of income.

In September 2011, the FASB issued ASU No. 2011-08, *Testing Goodwill for Impairment,* (ASC Topic 350). Under the amendments in this ASU, an entity has 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, after assessing the totality of events or circumstances, an entity determines 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. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss, if any. Under the amendments in this ASU, an entity also has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has not been a material change in our exposure to interest rate and foreign currency risks from that described in our 2011 Annual Report on Form 10-K.

Interest Rate Risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and the fixed rate note receivable from SemiSouth. 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. In the first quarter of 2012, we changed our investment policy to allow the sale of long-term and short-term investments prior to their stated maturity date. We generally hold securities until maturity; however, they may now 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 change in policy we classify our investment portfolio as available-for-sale as opposed to held-to-maturity. We do not use derivative financial instruments in our investment portfolio to manage our interest rate risk, foreign currency risk, or for any other purpose. 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 March 31, 2012 , and December 31, 2011 , we held primarily cash equivalents and short-term and long-term investments with fixed interest rates.

Foreign Currency Exchange Risk. As of March 31, 2012, our primary transactional currency was in U.S. dollars, however we have sales offices in various foreign countries in which our expenses are denominated in the local currency, primary Asia and Western Europe. As of March 31, 2012 we did not employ a foreign currency hedge program utilizing foreign currency forward exchange contracts.

Two of our major suppliers, Seiko Epson Corporation, or Epson, and ROHM Lapis Semiconductor Co., Ltd., or Lapis, 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 Power Integrations 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 1 percentage point; 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.

At March 31, 2012 , and December 31, 2011 , we did not have material cash or investments denominated in foreign currencies, and therefore had no material foreign currency exchange risk related to our cash and investments.

ITEM 4. CONTROLS AND PROCEDURES

Limitation on Effectiveness of Controls

Any control system, no matter how well designed and operated, can provide only reasonable assurance as to the tested objectives. The design of any control system is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. The inherent limitations in any control system include the realities that judgments related to decision-making can be faulty, and that reduced effectiveness in controls can occur because of simple errors or mistakes. Due to the inherent limitations in a cost-effective control system, misstatements due to error may occur and may not be detected.

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 (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 Quarterly Report on Form 10-Q, 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. 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.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended March 31, 2012 , which materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information with respect to this item may be found in Note 12, *Legal Proceedings and Contingencies*, in our Notes to Condensed Consolidated Financial Statements included earlier in this Quarterly Report on Form 10-Q, which information is incorporated herein by reference.

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. The risks facing our business have not changed substantively from those discussed in our Annual Report on Form 10-K for the year ended December 31, 2011, except for those risk factors below designated by an asterisk (*).

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:

- competitive pressures on selling prices;
- 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;
- 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;
- an audit by the Internal Revenue Service, which is asserting that we owe additional taxes relating to a number of tax related positions;
- reliance on international sales activities for a substantial portion of our net revenues;
- risks associated with acquisitions and strategic investments;
- our ability to successfully integrate, or realize the expected benefits from, our acquisitions;
- fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen;
- the volume and timing of delivery of orders placed by us with our wafer foundries and assembly subcontractors, and

their ability to procure materials;

- earthquakes, terrorists acts or other disasters;
- continued impact of recently enacted 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;
- our ability to develop and bring to market new products and technologies on a timely basis;
- the ability of our products to penetrate additional markets;
- the volume and timing of orders received from customers;
- our ability to attract and retain qualified personnel;
- changes in environmental laws and regulations, including with respect to energy consumption and climate change; and
- interruptions in our information technology systems.

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 2012 to 2029. 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 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, standby power supplies for PCs, and power supplies for 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.

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 for patent infringement in China, where the outcome of litigation can be more uncertain than in the United States. Should we ultimately be determined to be infringing on 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.

**We are being audited by the Internal Revenue Service which is asserting that we owe additional taxes relating to a number of tax related positions, and if we are not successful in defending our positions we may be obligated to pay additional taxes, as well as penalties and interest, and may also have a higher effective income tax rate in the future.* 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 the quarter ended March 31, 2011, we received Notices of Proposed Adjustments from the IRS showing proposed material changes to our taxable income for fiscal years 2003 through 2006, primarily related to our intercompany research and development cost-sharing arrangement. In December 2011, we received an addendum to the notice of proposed adjustments from the IRS related to our intercompany research and development cost sharing arrangement. The fiscal years 2007 through 2009 are also under audit by the IRS. While the IRS has not completed its audit for these years, we anticipate that it will again propose an adjustment related to our intercompany research and development cost-sharing arrangement. We believe the IRS's position with respect to the proposed adjustment related to our research and development cost-sharing arrangement is inconsistent with applicable tax law, and that we have a meritorious defense to our position. Accordingly, we intend to continue to challenge the IRS's position on this matter vigorously. While we believe the IRS's asserted position on this matter is not supported by applicable law, we may be required to make additional payments in order to resolve this matter. If this matter is litigated and the IRS is able to successfully sustain its position, our results of operations and financial condition could be materially and adversely affected. Resolution of this matter could take considerable time, possibly years.

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 Americas account for, and have accounted for a large portion of our net revenues, including approximately 96% of our net revenues for three months ended March 31, 2012 and for the year ended December 31, 2011. 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.

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. 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;
- 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 make strategic investments in other companies, which may decline in value and/or not meet desired objectives. The success of these strategic investments depends on various factors over which we may have limited or no control and requires ongoing and effective cooperation with strategic partners. Moreover, these investments are often illiquid, such that it may be difficult or impossible for us to monetize such investments.

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, 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.

Fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen, may impact our gross margin . Two of our major suppliers, Epson and Lapis, 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 Power Integrations and each of these suppliers.

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 in April 2018, August 2014, December 2012 and December 2020, respectively. 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.

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. (Recent increases in the price of gold and copper, which are used in our IC packages and lead frames, respectively, have in fact increased our product costs to some degree.) 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.

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 recent 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 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.

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 66% of our net revenues in the three months ended March 31, 2012, and 62% of our net revenues for the year ended December 31, 2011. 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.

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.

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.

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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In November 2011, our board of directors authorized the use of $30.0 million for the repurchase of our common stock. In the first quarter of 2012, in connection with the execution of our acquisition of Concept, our board of directors canceled this stock repurchase program. Authorization of future stock repurchase programs are 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.

ITEM 4. MINE SAFETY DISCLOSURES

None

ITEM 6. EXHIBITS

See the Exhibit Index immediately following the signature page to this Quarterly Report on Form 10-Q, which is incorporated by reference here.

SIGNATURES

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

	POWER INTEGRATIONS, INC.
Dated: May 7, 2012	By: /s/ SANDEEP NAYYAR
	Sandeep Nayyar Chief Financial Officer (Duly Authorized Officer and Principal Financial Officer and Chief Accounting Officer)

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INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
2.1	Share Purchase Agreement, dated March 30, 2012, by and between Heinz Rüedi, Power Integrations Netherlands B.V. and Power Integrations Limited regarding shares of Concept Beteiligungen AG and CT-Concept Holding AG. (As filed with the SEC as Exhibit 2.01 to our Current Report on Form 8-K on May 7, 2012, SEC File No. 000-23441.)*
3.1	Restated Certificate of Incorporation. (As filed with the SEC as Exhibit 3.1 to our Annual Report on Form 10-K on February 29, 2012, SEC File No. 000-23441.)
3.2	Amended and Restated Bylaws. (As filed with the SEC as Exhibit 3.1 to our Current Report on Form 8-K on January 30, 2012, SEC File No. 000-23441.)
4.1	Reference is made to Exhibits 3.1 and 3.2.
10.1	Amendment Number Three to Wafer Supply Agreement, effective as of February 1, 2012, by Power Integrations International Ltd. and Seiko Epson Corporation.*
10.2	Wafer Supply Agreement, made and entered into as of this 1st day of October, 2010, by and between Power Integrations International, Ltd., and X-FAB Semiconductor Foundries AG.*
10.3	Credit Agreement, dated February 22, 2011, by and between Power Integrations, Inc. and Wells Fargo Bank, National Association.
10.4	Amendment to Credit Agreement, dated August 2, 2011, by and between Power Integrations, Inc. and Wells Fargo Bank, National Association.
10.5	Second Amendment to Credit Agreement, dated April 2, 2012, by and between Power Integrations, Inc. and Wells Fargo Bank, National Association.
10.6	2012 Executive Officer Cash Compensation Arrangements and 2012 Bonus Plan (As described in Item 5.02 of our Current Report on Form 8-K filed with the SEC on January 30, 2012, SEC File No. 000-23441.)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

All references in the table above to previously filed documents or descriptions are incorporating those documents and descriptions by reference thereto.

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* Confidential treatment has been requested for portions of this exhibit.

** The certifications attached as Exhibits 32.1 and 32.2 accompanying this Form 10-Q, are not deemed filed with the SEC, and are not to be incorporated by reference into any filing of Power Integrations, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-Q, irrespective of any general incorporation language contained in such filing.

Exhibit 10.1

AMENDMENT NUMBER THREE

TO

WAFER SUPPLY AGREEMENT

This Amendment Number Three (the "Amendment"), effective as of February 1, 2012 (the "Amendment Effective Date"), amends the Wafer Supply Agreement effective April 1. 2005. As amended by Amendment Number One effective December 19, 2008 and Amendment Number Two effective September 13, 2010, (as amended, the Agreement"') by and between **:**

(1) POWER INTEGRATIONS INTERNATIONAL LTD., a Cayman Islands corporation having a place of business at 4th Floor, Century Yard, Cricket Square, Elgin Avenue, P.O. Box 32322, Grand Cayman K Y 1-1209 ("Power Integrations")

and

(2) SEIKO EPSON CORPORATION, a Japanese corporation having a place of business at 281 Fujimi, Fujimi-machi, Suwa-gun, Nagano-ken, 399-0293 Japan ("Seiko Epson").

RECITALS

WHEREAS, pursuant to the terms of the Agreement, Power Integrations grants to Seiko Epson licenses of certain of Power Integrations' intellectual property for the sole purpose of Power Integrations acquiring from Seiko Epson the fabrication and supply of wafers of certain power IC products; and

WHEREAS, Power Integrations and Seiko Epson desire to amend the terms of the Agreement; and

WHEREAS, in accordance with Section 18.10 of the Agreement, the Agreement may be amended only by an instrument in writing duly executed by authorized representatives of Seiko Epson and Power Integrations.

Now, Therefore, in consideration of the mutual promises contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereby amend the Agreement as follows:

AGREEMENT

1 Exhibit B of the Agreement is deleted in its entirety and replaced with Exhibit B in the form attached hereto.

2 Effective as of the Amendment Effective Date, all references in the Agreement to the "Agreement" or "this Agreement" shall mean the Agreement as amended by this Amendment. Except as expressly amended

[*] = CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY BRACKETS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

herein, the terms of the Agreement continue unchanged and shall remain in full force and effect. This Amendment may be executed in one or more counterparts, each of which shall be considered an original, but all of which counterparts together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have caused this Amendment to be executed by their duly authorized representatives, effective as of the Amendment Effective Date.

SEIKO EPSON CORPORATION		POWER INTEGRATIONS INTERNATIONAL, LTD.	
By:	/s/ Kazuhzro Takenaka	By:	/s/ John Tomlin
Name:	Kazuhzro Takenaka	Name:	John Tomlin
Title:	Deputy COO, Microdevice	Title:	President

Exhibit B

WAFER PRICES FOR VOLUME PRODUCTION OF [*] INCH WAFERS BY
MONTHLY ORDER VOLUME

For [*] and [*] WAFERS in both PILOT PRODUCTION and VOLUME PRODUCTION:

Monthly [*] WAFER Volume	[*] Price/[*] Price
Less than [*]	[*]
[*]	[*]
[*] and above	[*]

Pricing will be reviewed and mutually agreed to in writing on an annual basis.
For WAFERS in ENGINEERING PRODUCTION, the price for each entry of the above table will be multiplied by [*].

The above prices are the WAFER'S BASE_ PRICE and are based on an exchange rate of [*] ¥/$. The fluctuation in foreign exchange rate, as supplied by the Wall Street Journal will be shared equally by each party as follows F/X_BASE = [*]¥/$

Initial F/X_RATE = [*] ¥/$

A new F/X_RATE is only established at the time of placing a PO for WAFERS if the [*] is equal to or greater than [*]¥ from the F/X-BASE. The new F/X RATE will be set to the [*] and will remain in effect for at least the [*] it was established.

The actual PURCHASE_PRICE for WAFERS, by WAFER TYPE, used at the time of order will be calculated by the following formula:

PURCHASE _PRICE =
[*]

Examples: For DS WAFERS with a BASE PRICE of [*]

1. Nominal F/X Rate Example: F/X_RATE = in the range of [*]¥ to [*]¥:
PURCHASE_PRICE = BASE_ PRICE

2. Higher F/X Rate Example: New F/X_RATE = [*]¥:
PURCHASE_PRICE = [*] = [*]

3. Lower F/X Rate Example: New F/X_RA TE = [*]¥:
PURCHASE_PRICE = [*] = [*].

[*] = CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY BRACKETS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

Exhibit 10.2

WAFER SUPPLY AGREEMENT

This Wafer Supply Agreement ("AGREEMENT") is made and entered into as of this 1st day of October, 2010 (the "EFFECTIVE DATE"), by and between:

(1) Power Integrations International, Ltd., a Cayman Islands corporation having its principal place of business at 4th Floor, Century Yard, Cricket Square, Elgin Avenue, P.O. Box 32322, Grand Cayman KY1-1209 ("POWER INTEGRATIONS"); and

(1) X-FAB Semiconductor Foundries AG having its principal place of business at Haarbergstrasse 67, 99097 Erfurt, Germany ("COMPANY").

There is a Wafer Supply Agreement dated the 23rd day of May, 2003 (the "2003 AGREEMENT"), by and between:

(1) Power Integrations, Inc., a Delaware corporation having its principal place of business at 5245 Hellyer Ave., San Jose, CA U.S.A. 95138; and

(2) ZMD Analog Mixed Signal Services GmbH & CoKG, a German corporation having its principal place of business at Grenzstrasse 28, 01109 Dresden, Germany (later X-FAB Dresden Gmbh & Co KG) [*].

WITNESSETH:

WHEREAS, COMPANY is engaged in providing wafer foundry services for IC companies; and

WHEREAS , COMPANY wishes to qualify X-FAB [*], Inc. (" X-FAB [*]") to fabricate and fill wafer orders on behalf of the COMPANY; and

WHEREAS, POWER INTEGRATIONS is engaged in the design, development, marketing and sale of various IC products for use in power source applications; and

WHEREAS, POWER INTEGRATIONS desires to acquire from COMPANY fabrication and supply of wafers of certain IC products from COMPANY's X-FAB [*] and X-FAB [*] facilities, and COMPANY is willing to supply such wafers to POWER INTEGRATIONS within the limitation of available production capacity of SUPPLIER (as defined below).

NOW, THEREFORE, in consideration of the mutual covenants of the parties contained herein, POWER INTEGRATIONS and COMPANY hereby agree as follows:

Article 1 . (Definitions)

When used throughout this Agreement, each of the following terms shall have the meaning indicated below:

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

1.1 COMMON SPECIFICATION(S): The specifications for the production, delivery and acceptance of the WAFERS including the PI PROCESS, PI specifications and production practices as defined by PI and, in addition, the specifications currently in use by SUPPLIER to produce and deliver WAFERS to PI during the Term of this Agreement.

1.2 CONFIDENTIAL INFORMATION: Technical information, or other non-public information relating to PI or SUPPLIER, whether in a man-readable or machine-readable form and whether recorded on paper, tape, diskette or any other media, which is disclosed by the disclosing party to the receiving party, and subject to Section 1.3 ("CONFIDENTIAL MANUFACTURING INFORMATION"), (i) which is designated in writing, by appropriate legend, as confidential or, (ii) if disclosed orally is identified as confidential information at the time of disclosure and a summary of which is confirmed in writing within thirty (30) days after oral disclosure and designated, by appropriate legend, as confidential. Notwithstanding the foregoing, all information generated by the activities and actions of SUPPLIER under this Agreement on PI's behalf and any information, including all PI INTELLECTUAL PROPERTY received from PI by SUPPLIER, to effect the terms of this Agreement shall also be considered PI's CONFIDENTIAL INFORMATION.

1.3 CONFIDENTIAL MANUFACTURING INFORMATION: PI's CONFIDENTIAL INFORMATION that is or relates to the PI PROCESS. CONFIDENTIAL MANUFACTURING INFORMATION is CONFIDENTIAL MANUFACTURING INFORMATION in all cases, whether or not marked as or declared to be confidential. Any unmarked or oral information relating to the PI PROCESS conveyed during a meeting between the parties will be CONFIDENTIAL MANUFACTURING INFORMATION by default whether or not declared or marked confidential and whether or not it is subsequently described in writing.

1.4 ENGINEERING WAFERS: WAFERS that are processed in accordance with the applicable special pricing in Exhibit B and any applicable special specifications provided by PI.

1.5 INDIVIDUAL SALES CONTRACTS: Individual contracts of sale and purchase of the WAFERS that will be concluded between SUPPLIER and PI pursuant to this Agreement.

1.6 INTELLECTUAL PROPERTY RIGHTS : Copyrights, patents, trade secrets, moral rights, know−how and all other intellectual or proprietary rights of any kind, as applicable to either party.

1.7 MASK SPECIFICATIONS: The specifications for the production, delivery and acceptance of the MASK TOOLING SETS which are set forth in the COMMON SPECIFICATIONS.

1.8 MASK TOOLING SETS: Those mask tooling sets made by or for SUPPLIER for use in making WAFERS pursuant to this Agreement.

1.9 PI: POWER INTEGRATIONS and any of its SUBSIDIARIES.

1.10 PI IMPROVEMENTS: Any modification or change, during the term of this Agreement, to the PI PROCESS, the COMMON SPECIFICATIONS, any PI provided information in the MASK TOOLING SETS, or the mask databases that are made solely by PI or made jointly by PI and SUPPLIER.

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

1.11 SUPPLIER IMPROVEMENTS: Any modification or change, during the term of this Agreement, to the PI PROCESS, the COMMON SPECIFICATIONS, any PI provided information in the MASK TOOLING SETS, or the mask databases that (i) are made solely by SUPPLIER without use of PI CONFIDENTIAL INFORMATION, and (ii) for which SUPPLIER has a substantial use other than manufacturing or incorporation into PRODUCTS, and (iii) are based on the SUPPLIER PROCESS.

1.12 PI INTELLECTUAL PROPERTY : The PI PROCESS, the COMMON SPECIFICATIONS, any PI provided information in the MASK TOOLING SETS, the mask databases, the PI IMPROVEMENTS, and all INTELLECTUAL PROPERTY RIGHTS in the foregoing.

1.13 BACKGROUND TECHNOLOGY means any ideas, concepts, information, materials, processes, data, programs, know-how, improvements, discoveries, developments, designs, artwork, formulae, other copyrightable works, and technique: (a) created, acquired or otherwise developed prior to May 23, 2003 by a party, or (b) developed entirely outside the scope of this AGREEMENT and the 2003 AGREEMENT without reference to the CONFIDENTIAL INFORMATION of the other party; and all INTELLECTUAL PROPERTY RIGHTS related thereto.

1.14 PI PROCESS: PI's process technologies, which are implemented in the SUPPLIER wafer fabrication facility to produce the WAFERS, and of which the detailed specification is specified in the COMMON SPECIFICATIONS, plus all PI IMPROVEMENTS.

1.15 PILOT PRODUCTION: The production by SUPPLIER of WAFERS for the purpose of evaluation by PI.

1.16 PRODUCTS: Any and all IC products of PI which will be manufactured in accordance with the PI PROCESS.

1.17 SUBSIDIARY: Any corporation, company or other entity in which COMPANY or POWER INTEGRATIONS, as the case may be, owns and/or controls, directly or indirectly, now or hereafter, more than fifty percent (50%) of the outstanding shares of stock entitled to vote for the election of directors or their equivalents regardless of the form thereof (other than any shares of stock whose voting rights are subject to restriction); provided, however, that any entity which would be a SUBSIDIARY by reason of the foregoing shall be considered a SUBSIDIARY only so long as such ownership or control exists. COMPANY and POWER INTEGRATIONS shall each enter into separate written agreements (each a “SUBSIDIARY AGREEMENT”) with each of their respective SUBSIDIARIES who wish to exercise any rights under this Agreement, binding the SUBSIDIARY to the terms and conditions of this Agreement. A SUBSIDIARY shall maintain its status as a SUBSIDIARY under this Agreement only for so long as such SUBSIDIARY has a SUBSIDIARY Agreement in force and effect. COMPANY and POWER INTEGRATIONS each guarantee to the other the performance of their respective SUBSIDIARIES under this Agreement, and each will indemnify and hold harmless the other from any costs, damages, or liabilities incurred by the other arising out of a breach by a SUBSIDIARY of the terms and conditions of this Agreement. Notwithstanding anything to the contrary in this AGREEMENT, unless the parties expressly agree otherwise in writing, the only COMPANY SUBSIDIARIES authorized to exercise rights and perform obligations under this AGREEMENT are X-FAB [*] and X-FAB [*].

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

1.18 SUPPLIER: COMPANY, X-FAB [*], and X-FAB [*].

1.19 SUPPLIER PROCESS: SUPPLIER's standard process technology steps, from SUPPLIER owned technologies, developed exclusively by SUPPLIER and implemented in the SUPPLIER wafer fabrication facility to produce the WAFERS.

1.20 VOLUME PRODUCTION: The production by SUPPLIER of WAFERS for the volume production of PRODUCTS.

1.21 WAFER(S): Non-probed silicon wafers produced during the PILOT PRODUCTION and VOLUME PRODUCTION which meet the COMMON SPECIFICATIONS and that may be identified by additional specifications in an exhibit that is added hereto by written agreement of the parties.

1.22 WAFER TYPE . The different types of WAFERS (e.g., size, location of manufacture) as defined by the COMMON SPECIFICATIONS.

Article 2 .(Foundry Capacity and Forecasts)

2.1 SUPPLIER agrees using best efforts to provide to PI the foundry capacity (“FOUNDRY CAPACITY”) as set forth in Exhibit A. Annually, PI will provide SUPPLIER with a twelve (12) month forecast of WAFER orders by WAFER TYPE (“PI ANNUAL FORECAST”). Annually during the Term of this Agreement and in advance of the beginning of SUPPLIER's fiscal year, SUPPLIER and PI will jointly review the PI ANNUAL FORECAST and SUPPLIER's FOUNDRY CAPACITY for the upcoming SUPPLIER fiscal year. Annually, at the beginning of SUPPLIER's fiscal year during the Term of this Agreement, SUPPLIER will define a FOUNDRY CAPACITY for the current SUPPLIER fiscal year, at each of the SUPPLIER's plants making WAFERS for PI, in an amount no less than [*]%) of PI's total WAFER purchases by WAFER TYPE during the previous SUPPLIER fiscal year, provided the FOUNDRY CAPACITY does not exceed the MAXIMUM FOUNDRY CAPACITY for the PI PROCESS (cif Exhibit A) based on weekly capacity break down. During the SUPPLIER fiscal year, SUPPLIER shall consider up to a [*]%) upside request over the current FOUNDRY CAPACITY, by WAFER TYPE, upon a [*] month written advance notice from PI, unless the current FOUNDRY CAPACITY represents [*]%) of SUPPLIER's total capacity in which case such advance notice shall be a [*] month written notice. Either party can request the other party to negotiate to reduce the FOUNDRY CAPACITY, by WAFER TYPE, for the then current SUPPLIER fiscal year, if SUPPLIER and PI determine that PI will not order at least [*]%) of the PI ANNUAL FORECAST by WAFER TYPE or SUPPLIER can not provide FOUNDRY CAPACITY for justifiable reasons. Any negotiated reduction in FOUNDRY CAPACITY must be agreed to by PI and SUPPLIER in writing.

2.2 PI shall provide SUPPLIER, on or before a mutually agreed day of each calendar month, a written [*] month forecast for wafer starts (“PI MONTHLY FORECAST”) of the quantity of the WAFERS of each PRODUCT to be manufactured and delivered during [*].

2.3 PI must order at least the quantity of WAFERS by WAFER TYPE (a) forecasted in the first [*] months of the PI MONTHLY FORECAST and (b) confirmed by SUPPLIER in accordance with Section 2.4, unless SUPPLIER agrees to any change. PI may revise the quantity of WAFERS for

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each of the upcoming last [*] months of each PI MONTHLY FORECAST but must meet at least [*]% of the previous forecast for month [*],[*] of month [*] and [*]% of months [*] if PI is greater than [*]% of XFAB's utilized capacity. XFAB must submit monthly a report defining what percent of XFAB's capacity PI is utilizing (current and projected). If PI is less than [*]% of utilized capacity then PI can make unlimited changes to months [*].

2.4 The PI MONTHLY FORECAST will be either [*] or [*] for each forecasted month so as to align with SUPPLIER's manufacturing calendar.

Within [*] days after receipt of each PI MONTHLY FORECAST, SUPPLIER will confirm in writing to PI whether it will increase the FOUNDRY CAPACITY to meet any amounts of the PI MONTHLY FORECAST above the Wafer Commitment.

Notwithstanding the foregoing, to the extent SUPPLIER is unable to fulfill any PO from PI because of quality or other SUPPLIER issues ("Unfulfilled Wafers"), then PI will have no obligation to purchase the Unfulfilled Wafers.

Article 3 . (Sale and Purchase of WAFERS; MASK TOOLING SETS)

3.1 As implementation of the foundry services provided in the preceding Article, PI shall purchase from SUPPLIER, and SUPPLIER shall sell to PI, those WAFERS ordered pursuant to the terms and conditions of this Agreement, which shall be non-probed WAFERS.

3.2 Subject to the provisions of Section 3.1 above and 5.2 ("VOLUME PRODUCTION") below, PI shall submit to SUPPLIER a purchase order (the "PO") for the WAFERS, which PO shall be substantially in line with the provisions of Section 2.3 above. All PO's shall be subject to acceptance by SUPPLIER through issuance of a written confirmation within five (5) business days of receipt of the PO. Upon such written confirmation only, the PO terms of total quantity, delivery time and pricing shall constitute an INDIVIDUAL SALES CONTRACT which will be deemed to incorporate all of the terms and conditions of this Agreement. The confirmed PO shall be irrevocable except as set forth in Section 2.3 above. The mix of PRODUCTS and the quantity of WAFERS, by WAFER TYPE, allocated per each of the PRODUCTS in any INDIVIDUAL SALES CONTRACT can be modified at any time, prior to the week the WAFERS will be started, by PI with confirmation from SUPPLIER so long as the total quantity of all WAFERS, by WAFER TYPE, is not less than the total quantity set forth in the INDIVIDUAL SALES CONTRACT.

3.3 The mask databases for creating MASK TOOLING SETS for WAFERS of any PRODUCT shall be supplied by PI to SUPPLIER [*] before its commencement of the WAFERS' fabrication at no cost to SUPPLIER. SUPPLIER will produce or procure the MASK TOOLING SETS for the WAFERS. The cost of production or procurement of the MASK TOOLING SETS shall be paid by PI and the MASK TOOLING SETS shall be owned by SUPPLIER, subject to Section 4.1. If, upon SUPPLIER's examination, the MASK TOOLING SETS are found to be defective or not in conformance with the MASK SPECIFICATIONS, SUPPLIER shall immediately notify PI in detail as to such defects or non-conformity, and PI shall either provide corrected mask databases and pay for corrected MASK TOOLING SETS or, notwithstanding any other provision of this Agreement, PI can cancel the INDIVIDUAL SALES CONTRACT for the affected WAFERS, upon written notice to SUPPLIER, without any liability except for affected WAFER work in progress ("WIP")

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and inventory. The price to PI for the MASK TOOLING SETS shall be SUPPLIER's cost to produce or procure them, and shall be commercially reasonable. If PI determines that the price or quality of the MASK TOOLING SETS is not acceptable then, at PI's option, the SUPPLIER will procure the MASK TOOLING SETS from a vendor specified by PI.

Article 4 .(INTELLECTUAL PROPERTY RIGHTS)

4.1 PI is and shall remain the sole and exclusive owner of all right, title and interest in the PI INTELLECTUAL PROPERTY. Subject to all of the terms and conditions of this Agreement, PI grants SUPPLIER a limited, non-exclusive license in the PI INTELLECTUAL PROPERTY for the sole purpose of using it internally to manufacture WAFERS for PI in accordance with the terms and conditions of this Agreement. SUPPLIER may not use the PI INTELLECTUAL PROPERTY for any other purpose or license it to any third party, unless a separate written agreement for any such rights is executed by PI.

4.2 PI shall be the sole and exclusive owner of all right, title and interest in the PI IMPROVEMENTS. SUPPLIER hereby does and will irrevocably and unconditionally transfer and assign to PI all of SUPPLIER's right, title and interest worldwide in the PI IMPROVEMENTS. SUPPLIER will promptly disclose in writing all PI IMPROVEMENTS to PI promptly upon their creation. SUPPLIER shall take all reasonable actions, at PI's expense, to assist PI in perfecting and enforcing its rights in the PI IMPROVEMENTS. Such actions shall include but not be limited to execution of assignments, patent applications and other documents. Subject to all of the terms and conditions of this Agreement, PI hereby grants to SUPPLIER a non-exclusive, irrevocable, perpetual, royalty-free, non-transferable, worldwide, right and license, under all of its INTELLECTUAL PROPERTY RIGHTS to use, modify, reproduce, (but sub-license only to a SUPPLIER SUBSIDIARY) the PI IMPROVEMENTS for SUPPLIER's internal use only except that no license is granted to the PI IMPROVEMENTS for the purpose of SUPPLIER provided foundry service or other benefit to a third party.

4.3 In the event that any portion of Section 4.2 is declared invalid or illegal according to any applicable law, SUPPLIER hereby waives and agrees never to assert such rights, including any moral rights or similar rights, against PI or its licensees.

4.4 In the event that any portion of Section 4.2 is declared invalid or illegal according to any applicable law, the parties hereby modify such portion, effective upon such declaration, in such manner as shall secure for PI, and SUPPLIER hereby grants and agrees to grant to PI, an exclusive, irrevocable, perpetual, worldwide, fully paid and royalty-free license under all INTELLECTUAL PROPERTY RIGHTS, with rights to sublicense through one or more level(s) of sublicensee(s), to use, modify, reproduce, create derivative works of, distribute, publicly perform and publicly display by all means now known or later developed, and otherwise exploit in any manner such rights in the PI IMPROVEMENTS, to the maximum extent permitted by applicable law.

4.5 SUPPLIER shall be the sole and exclusive owner of all right, title and interest in the SUPPLIER IMPROVEMENTS. SUPPLIER hereby grants to PI a non-exclusive, irrevocable, perpetual, royalty-free, non-transferable, worldwide, right and license, under all of its INTELLECTUAL PROPERTY RIGHTS in the SUPPLIER IMPROVEMENTS to exploit such SUPPLIER

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IMPROVEMENTS in any manner, but solely to the extent they are used as part of the PI PROCESS and any modifications thereto. Without any consent of SUPPLIER, PI may sublicense the foregoing license for the SUPPLIER IMPROVEMENTS to PI's SUBSIDIARY so long as the sublicense provides for the protection of SUPPLIER's CONFIDENTIAL INFORMATION on terms not less protective of SUPPLIER's rights than those set forth in this Agreement. SUPPLIER will promptly disclose in writing all SUPPLIER IMPROVEMENTS to PI upon PI's request.

4.6 SUPPLIER agrees not to use the PI INTELLECTUAL PROPERTY or any license under this Agreement in whole or in part, or any knowledge gained by SUPPLIER through producing WAFERS for PI to develop an equivalent or competing process or other product or service that would compete with PI. Subject to the previous sentence, SUPPLIER may produce any type or variety of product, technology or service whatsoever in order to conduct business with its other customers.

4.7 In the case of a jointly developed PI IMPROVEMENT, SUPPLIER may request that a license be granted for use in non-PI PRODUCTS that do not directly compete with PI PRODUCTS, such license shall not be unreasonably withheld.

4.8 As between the parties, each party shall own and hold all right, title and interest in and to all such party's BACKGROUND TECHNOLOGY. No right or license in such party's BACKGROUND TECHNOLOGY is granted to the other party, except as necessary to perform the other party's obligations under this Agreement or as specifically granted in this Agreement.

Article 5 .(PILOT PRODUCTION and Minimum Order Quantity)

5.1 PILOT PRODUCTION

5.1.1 For the PILOT PRODUCTION, PI shall, if PI desires to, place a PO with SUPPLIER for a minimum of [*] WAFER starts (one (1) pilot lot) or multiples thereof per each PRODUCT.

5.1.2 The output of the PILOT PRODUCTION will be shipped to PI if the WAFERS output is at least [*]%) of the ordered quantity. If the WAFERS output is less than [*]%) of the ordered quantity, SUPPLIER will inform PI of the output quantity of the WAFERS, and if PI requires to have the shortage covered, SUPPLIER will re-input the WAFERS to cover the shortage of quantity at no additional cost to PI.

5.2 VOLUME PRODUCTION

5.2.1 For the VOLUME PRODUCTION, PI shall place a PO with SUPPLIER for a minimum of [*] WAFER starts (one (1) lot) or multiples thereof per each PRODUCT and SUPPLIER will ship monthly orders in quantities not less than [*]%) of the quantities ordered of each PRODUCT.

5.2.2 The orders of PI for the VOLUME PRODUCTION shall be subject to the provisions of Section 3.2 above.

Article 6 . (Delivery)

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

6.1 The terms of delivery of the WAFERS from X-FAB [*] shall be DAP (destination specified in POWER INTEGRATIONS PO) Incoterms 2010. The terms of delivery of the WAFERS from X-FAB [*] shall be DAP (destination specified in POWER INTEGRATIONS PO) Incoterms 2010.

6.2 The risk of loss relating to the WAFERS delivered by SUPPLIER to PI shall transfer from SUPPLIER to PI at such time and point as provided in Incoterms 2010 relating to such DAP term. Title to the WAFERS delivered by SUPPLIER to PI shall transfer from SUPPLIER to PI upon arrival at the destination specified in POWER INTEGRATIONS PO. PI shall have the right to designate a freight forwarder, subject to SUPPLIER's reasonable approval. PI will pay freight.

6.3 SUPPLIER will deliver the WAFERS within the number of calendar days specified in the INDIVIDUAL SALES CONTRACT. In the event that SUPPLIER foresees a delay in the delivery schedule of the WAFERS, SUPPLIER shall make a best effort to correct any delay and SUPPLIER shall promptly notify PI of such delay and submit to PI the new delivery schedule. PI will have the right to cancel, without liability, the INDIVIDUAL SALES CONTRACT for the delayed WAFERS if the delay is greater than [*] days.

6.4 SUPPLIER shall pack the WAFERS in accordance with the packing standards defined in the COMMON SPECIFICATIONS.

6.5 SUPPLIER shall collect PCM data (“PCM DATA”), as defined in the COMMON SPECIFICATIONS, on the manufactured WAFERS. SUPPLIER will send the PCM DATA electronically to PI before the WAFERS are received by PI. The PCM DATA will be accurate and complete for all WAFERS and sent in a mutually agreed upon format.

6.6 In the case that PI determines, in consultation with SUPPLIER, that the WAFERS currently being manufactured will not meet the PRODUCTS requirements, PI can, notwithstanding any other provision of this Agreement, cancel the INDIVIDUAL SALES CONTRACT for the affected WAFERS without any liability except for the affected WAFER WIP and inventory, upon written notice to SUPPLIER.

Article 7 . (Test and Inspection)

7.1 PI shall conduct incoming inspection of the WAFERS, by WAFER TYPE, to determine the WAFERS' conformance to the COMMON SPECIFICATIONS. The PCM DATA specified in Section 6.5 is required for the incoming inspection of the WAFERS and the omission, inaccuracy or other defect in the PCM DATA will in itself be sufficient cause to reject the WAFERS. This inspection shall be regarded as final in terms of quality, quantity and other conditions of the WAFERS supplied to PI subject to SUPPLIER's warranty as defined in Section 11.1. All WAFERS passing the incoming inspection will be accepted by PI.

7.2 PI shall notify SUPPLIER which of the WAFERS have been accepted by PI within [*] business days after receipt of the WAFERS by PI. Should PI fail to notify SUPPLIER within the said [*] business days, the WAFERS shall be deemed to have been accepted by PI. PI will owe SUPPLIER payment only for the quantity of WAFERS that have been accepted by PI.

7.3 SUPPLIER shall not be held responsible for the defects and failures of the WAFERS which are attributable to the design, test and assembly by PI of the PRODUCTS.

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7.4 SUPPLIER shall not be held responsible for the defects, failures and yield problems of the WAFERS if the WAFERS meet the specifications set forth in the COMMON SPECIFICATIONS.

7.5 SUPPLIER may make a written special waiver request to PI to ship WAFERS that do not comply with the COMMON SPECIFICATIONS. If PI approves such special waiver request in writing, which approval may include special terms and conditions, SUPPLIER may ship such non-complying WAFERS under such terms and conditions.

Article 8 . (Process and Specification Changes)

8.1 SUPPLIER shall notify PI in writing as soon as possible, in advance and in accordance with the COMMON SPECIFICATIONS, of process changes which require PI's change in database or which would affect the quality, reliability, form, fit or function of the PRODUCTS. Each such process change shall be subject to PI's prior written approval. If PI does not approve and the process change is implemented, PI will have the right to cancel, without liability, any INDIVIDUAL SALES CONTRACT affected by the process change.

8.2 PI shall have sole responsibility for the control, maintenance, distribution and modification of the COMMON SPECIFICATIONS including but not limited to the addition and maintenance of applicable process, inspection, quality and procurement specifications. PI will notify SUPPLIER of any changes to the COMMON SPECIFICATIONS. SUPPLIER will acknowledge acceptance of the COMMON SPECIFICATIONS in writing and SUPPLIER's acceptance of the COMMON SPECIFICATIONS will not be unreasonably withheld. In the case of any issue with the COMMON SPECIFICATIONS, SUPPLIER agrees that PI is the ultimate authority on the COMMON SPECIFICATIONS.

Article 9 . (Price and Charge)

9.1 The prices of the WAFERS, which are produced both in the PILOT PRODUCTION and the VOLUME PRODUCTION are set forth in Exhibit B attached hereto. Any modifications thereto must be agreed upon by SUPPLIER and PI in writing, either as an amendment to EXHIBIT B or as part of an INDIVIDUAL SALES CONTRACT. SUPPLIER and PI may jointly review and revise the WAFERS' price, by WAFER TYPE, within [*] days of the close of SUPPLIER's fiscal year or upon a material change to the COMMON SPECIFICATIONS.

Article 10 . (Payments)

10.1 Payment for the WAFERS shall be by telephonic transfer [*] days after receipt of invoice and secured by a standby letter of credit to be opened at a first class bank acceptable to SUPPLIER. SUPPLIER agrees to negotiate terms or alternate forms of payment as proposed by PI.

10.2 For the [*] costs, PI has paid to SUPPLIER [*] ("[*] Cost") (i.e., [*] for the [*] and [*] for installation and fitting). SUPPLIER will pay PI back for the [*] Cost in the form of [*] discounts per wafer after the Rebate Milestone Date until SUPPLIER delivers and PI accepts [*] WAFERS ("Rebate Number of Wafers") (i.e., [*] = [*]). The "Rebate Milestone Date" means the date on which the [*] is qualified for production by PI.

10.3 If this Agreement is terminated in accordance with Article 13 ("Term and Termination") before

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SUPPLIER delivers and PI accepts the Rebate Number of Wafers the SUPPLIER shall immediately pay PI the following amount:

(a) [*]. For example, but without limitation, if PI has accepted [*] WAFERS between the Rebate Milestone Date and the termination date, then SUPPLIER shall pay PI [*] = [*].

If this Agreement expires before SUPPLIER delivers and PI accepts the Rebate Number of Wafers, SUPPLIER will have no obligation to pay PI any funds under this Section 10.3, provided the quantity of WAFERS delivered by SUPPLIER was not materially adversely affected by SUPPLIER's quality, production, or delivery problems.

Article 11 . (Warranty, Indemnification and Improvements)

11.1 SUPPLIER warrants that the WAFERS sold to PI will conform to their COMMON SPECIFICATIONS. PI shall notify SUPPLIER in writing of any non-conformity or defect of said WAFERS within [*] months after notification of acceptance per Section 7.2 above. SUPPLIER's sole obligations under this warranty are limited to, at PI's option, (i) replacing or reworking any said WAFERS which shall be returned to SUPPLIER's manufacturing facility with transportation charges prepaid, or (ii) SUPPLIER crediting an amount equal to the purchase price of said WAFERS.

11.2 SUPPLIER shall defend, indemnify and hold harmless PI, its officers, directors, employees and representatives from and against any claim, demand, cause of action, debt, or liability, including reasonable attorneys' fees, relating to or arising from allegations that the SUPPLIER PROCESS or SUPPLIER IMPROVEMENTS used to produce WAFERS or the resulting WAFERS infringes any patent, copyright, trade secret or other right of any kind of a third party; provided that SUPPLIER is promptly (within [*] days after initial legal notice to PI) notified in writing of the action and is allowed to assume and control the defense. SUPPLIER shall pay all damages and costs awarded therein, but shall not be responsible for any compromise or settlement made without SUPPLIER's consent.

11.3 EXCEPT AS EXPRESSLY STATED HEREIN, NO EXPRESS OR IMPLIED WARRANTIES ARE MADE BY SUPPLIER RELATING TO THE WAFERS, INCLUDING BUT NOT LIMITED TO WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE. PI MAKES NO REPRESENTATION OR WARRANTY OF ANY KIND WITH REGARD TO ANY OF THE PI INTELLECTUAL PROPERTY.

11.4 PI shall defend, indemnify and hold harmless SUPPLIER, its officers, directors, employees and representatives from and against any claim, demand, cause of action, debt, or liability, including reasonable attorneys' fees, relating to or arising from allegations that the PI PROCESS and any PI contributions to the PI IMPROVEMENTS used to produce WAFERS infringes any patent, copyright, trade secret or other right of any kind of a third party; provided that PI is promptly (within [*] days after initial legal notice to COMPANY) notified in writing of the action and is allowed to assume and control the defense. PI shall pay all damages and costs awarded therein, but shall not be responsible for any compromise or settlement made without PI's consent.

11.5 Notwithstanding Section 13.7, SUPPLIER shall keep records for [*] years, notwithstanding the

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termination of this Agreement, of the WAFERS manufactured and summaries of their process monitors. SUPPLIER agrees to permit such records to be examined and copied by PI or PI's authorized representative, upon reasonable prior written notice to SUPPLIER, during normal business hours at SUPPLIER's offices. Such records shall be deemed PI's CONFIDENTIAL INFORMATION.

Article 12 . (Confidentiality)

12.1 The receiving party shall use any CONFIDENTIAL INFORMATION acquired from the disclosing party in connection with this Agreement solely for the purposes of this Agreement.

12.2 Subject to Sections 12.7 and 12.8, for a period of [*] years after the receipt or creation of the CONFIDENTIAL INFORMATION, or during the Term of this Agreement, whichever is longer, the receiving party shall use a reasonable standard of care not to publish or disseminate the CONFIDENTIAL INFORMATION to any third party, except as otherwise provided herein. The receiving party shall have no obligation with respect to any CONFIDENTIAL INFORMATION received by it which the receiving party shall prove is:

(a) Published or otherwise available to the public other than by a breach of this Agreement or any other agreement by the receiving party

(b) Rightfully received by the receiving party hereunder from a third party not obligated under this Agreement or any other agreement, and without confidential limitation;

(c) Known to the receiving party prior to its first receipt of the same from the disclosing party;

(d) Independently developed by the receiving party without access to the CONFIDENTIAL INFORMATION of the other party;

(e) Furnished to a third party by the disclosing party without restrictions on the third party's right of disclosure similar to those of this Agreement; or

(f) Stated in writing by the disclosing party no longer to be CONFIDENTIAL INFORMATION.

In the case that the receiving party intends to disclose publicly or to a third party any CONFIDENTIAL INFORMATION under the previously defined exceptions above, the receiving party must first give the disclosing party written notice [*] days prior to any such disclosure.

12.3 If any CONFIDENTIAL INFORMATION is disclosed pursuant to the requirement or request of a governmental or judicial agency or disclosure is required by operation of law, such disclosure will not constitute a breach of this Agreement, provided that the receiving party shall give prior written notice to the disclosing party and seek a protective order with respect thereto reasonably satisfactory to the disclosing party to the extent available under applicable law.

12.4 The receiving party shall limit access to the CONFIDENTIAL INFORMATION only to such officers and employees of the receiving party who are reasonably necessary to implement this Agreement and only to such extent as may be necessary for such officers and employees to

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perform their duties. The receiving party shall be liable to cause all of such officers and employees to sign a secrecy agreement to abide by the secrecy obligations provided in this Agreement. The receiving party shall maintain records of such officers and employees.

12.5 CONFIDENTIAL INFORMATION and all materials including, without limitation, documents, drawings, masks, specifications, models, apparatus, sketches, designs and lists furnished to the receiving party by and which are themselves identified to be or designated in writing to be the property of the disclosing party are and shall remain the property of the disclosing party and shall be returned to the disclosing party promptly at its request, including any copies.

12.6 PI may disclose information with respect to any SUPPLIER IMPROVEMENTS to the PI PROCESS to one or more third parties as PI CONFIDENTIAL INFORMATION and covered by a non-disclosure agreement with protection equivalent to this Agreement for the sole purpose of having such third parties provide PI with design, layout, foundry, assembly and testing services.

12.7 CONFIDENTIAL MANUFACTURING INFORMATION will be confidential for a period of [*] years after the Term of this Agreement and SUPPLIER agrees to use its best efforts to never make public the CONFIDENTIAL MANUFACTURING INFORMATION. Notwithstanding any other provision of this Agreement, SUPPLIER shall treat the CONFIDENTIAL MANUFACTURING INFORMATION in accordance with the confidentiality obligations and use restrictions of this Agreement during that [*] year period.

12.8 SUPPLIER's obligations with respect to any portion of PI's CONFIDENTIAL MANUFACTURING INFORMATION shall terminate when SUPPLIER can document and with PI's written concurrence that such CONFIDENTIAL MANUFACTURING INFORMATION:

(a) Was rightfully in the public domain at the time it was communicated to SUPPLIER by PI; or

(b) Rightfully entered the public domain through no fault of SUPPLIER subsequent to the time it was communicated to SUPPLIER by PI; or

(c) Was rightfully in SUPPLIER's possession free of any obligation of confidence at the time it was communicated to SUPPLIER by PI; or

(d) Was rightfully communicated to SUPPLIER by a third party free of any obligation of confidence subsequent to the time it was communicated to SUPPLIER by PI; or

(e) Was independently developed by SUPPLIER and upon specific request of PI, SUPPLIER documents that the information was independently developed by the SUPPLIER.

For any CONFIDENTIAL MANUFACTURING INFORMATION to be subject to an exception above, any document containing such CONFIDENTIAL MANUFACTURING INFORMATION, and the information related thereto, must in their entirety qualify for the exception. This explicitly excludes any right to apply the exception by redacting CONFIDENTIAL MANUFACTURING INFORMATION or any part thereof from a document.

In the case that SUPPLIER intends to disclose to an unauthorized party PI's CONFIDENTIAL

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MANUFACTURING INFORMATION under the exceptions above, the SUPPLIER must first receive PI's prior written approval and such approval will be in PI's sole discretion.

12.9 PI may request the confidential release of SUPPLIER's CONFIDENTIAL INFORMATION to a customer of the PRODUCTS for purposes of such customer's evaluation or audit. SUPPLIER shall not unreasonably withhold approval of the release.

12.10 Obligation to Notify and Remedy . SUPPLIER will immediately give written notice to PI of any suspected unauthorized use or disclosure of PI's CONFIDENTIAL MANUFACTURING INFORMATION and SUPPLIER will be responsible for remedying such unauthorized use or disclosure. In the event that SUPPLIER or (to the knowledge of SUPPLIER) any of its representatives is requested or required (by oral questions, interrogatories, requests for information or documents in legal proceedings, subpoenas, civil investigative demands or other similar processes) to disclose any of PI's CONFIDENTIAL MANUFACTURING INFORMATION, SUPPLIER shall provide PI with prompt written notice of any such request or requirement sufficiently timely to allow PI adequate time to seek a protective order or other appropriate remedy and/or waive compliance with the provisions of this Agreement.

12.11 Notwithstanding Section 18.1 (“Entire Agreement”), the parties agree that the CMI Agreement previously entered into between Power Integrations, Inc. and X-FAB [*], the 2003 AGREEMENT, and the CMI Agreement previously entered into between Power Integrations, Inc. and X-FAB [*] (collectively the “PRIOR AGREEMENTS”) shall remain in full force and effect and govern POs and information exchanged prior to the EFFECTIVE DATE of this AGREEMENT. The PRIOR AGREEMENTS shall not govern POs and information exchanged after the EFFECTIVE DATE. All POs and information exchanged after the EFFECTIVE DATE will be governed by the terms and conditions of this AGREEMENT.

12.12 Notwithstanding anything to the contrary in this AGREEMENT, any activity performed by or information provided by any affiliate of POWER INTEGRATIONS in connection with this AGREEMENT will be deemed performed by or provided by POWER INTEGRATIONS.

Article 13 . (Term and Termination)

13.1 This Agreement shall continue in full force and effect from the Effective Date until [*], unless earlier terminated as provided herein (“Term”).

13.2 Notwithstanding anything to the contrary in Section 18.11 (“Force Majeure”), if any governmental agency, entity or authority requires (including through administrative guidance) any changes to this Agreement, PI may terminate this Agreement immediately if the changes are, in PI's sole discretion, detrimental to PI's interests or otherwise not reasonably acceptable to PI, without liability of any kind, except for affected WAFER work in progress (“WIP”) and inventory.

13.3 In the event that either party has committed a material breach of this Agreement, the other party shall promptly give written notice thereof to the breaching party, specifying any alleged material breach or breaches. The breaching party shall have sixty (60) days after the effective date of such written notice to have all material breaches specified either remedied or waived (“cured”). If such breaches are not so cured, the other party shall have the right to terminate this Agreement effective

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upon written notice.

13.4 Either party shall also have the right to terminate this Agreement with immediate effect by giving written notice of termination to the other party at any time upon or after the occurrence of any of the following events with respect to such other party:

(a) Insolvency, bankruptcy, reorganization or liquidation or filing of any application therefor, or other commitment of an affirmative act of insolvency, which is not promptly removed or stayed, if (1) the first party does not receive prompt, satisfactory, written assurance from the other party that it can meet its obligations under this Agreement, or (2) after such assurance such other party does not continue to meet such obligations;

(b) Attachment, execution or seizure of substantially all of the assets or filing of any application therefor which is not promptly released or stayed;

(c) Assignment or transfer of that portion of the business to which this Agreement pertains to a trustee for the benefit of creditors;

(d) Termination of its business or dissolution.

13.5 [*]

13.6 No failure or delay on the part of either party in exercising its right of termination hereunder for any one or more causes shall be construed to prejudice its rights of termination for such cause or any other or subsequent cause.

13.7 In the event of expiration or termination of this Agreement, within [*] days after expiration or termination of this Agreement, the receiving party shall return to the disclosing party all media and documentation containing the CONFIDENTIAL INFORMATION and render unusable all said CONFIDENTIAL INFORMATION placed in any storage apparatus under the receiving party's control. SUPPLIER will promptly produce for PI all documents in any form containing CONFIDENTIAL MANUFACTURING INFORMATION, whether made by PI or by SUPPLIER (including notes made by SUPPLIER), and whether such documents be in hard copy, electronic (including email), optical or other form.

13.8 The termination or expiration of this Agreement shall not release either party from any liability which at said date of termination or expiration has already accrued to the other party.

13.9 Notwithstanding any termination or expiration of this Agreement, the provisions of Articles 1 (“Definitions”), 4 (“INTELLECTUAL PROPERTY RIGHTS”), 11 (“Warranty, Indemnification and Improvements”), and 12 (“Confidentiality”), Sections 13.7, 13.8, 13.9, and Articles 14 (“Government Regulations”), 15 (“Non-Disclosure”), and 18 (“Miscellaneous Provisions”) shall survive this Agreement.

Article 14 . (Government Regulations)

14.1 Unless prior approval is obtained from the competent governmental agency, each party shall not knowingly export or re-export, directly or indirectly, any WAFERS to any country or countries to

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which export or re-export will violate any laws or regulations of the United States of America.

14.2 SUPPLIER is responsible for all taxes in respect of this Agreement except for taxes on PI's income.

Article 15 . (Non-Disclosure)

15.1 SUPPLIER shall keep the terms and existence of this Agreement confidential and shall not make disclosure thereof to any third party without the prior written consent of PI, which will be at PI's sole discretion and, if given, shall be conditioned upon all CONFIDENTIAL MANUFACTURING INFORMATION being redacted from such disclosure.

Article 16 . (Third Party Service Providers)

16.1 SUPPLIER shall have no right to have WAFERS manufactured, in whole or in part, by a third party unless PI gives its written approval therefor in advance, which approval shall be at PI's sole discretion. If PI does give such written approval, then SUPPLIER may disclose PI CONFIDENTIAL INFORMATION for the sole purpose of, and only to the extent reasonably necessary for, having such third party provide such services solely for the benefit if PI and not for the benefit of any other party. Such approval shall be conditioned upon:

(i) PI's prior review and written approval of the contract between SUPPLIER and such third party performing such manufacture; and

(ii) the third party agreeing in writing to all applicable terms and conditions of this Agreement, and;

(iii) SUPPLIER being the insurer and guarantor of such third party's full observance of such terms and conditions; and

(iv) SUPPLIER's disclosure of CONFIDENTIAL MANUFACTURING INFORMATION to such third party being subject to PI's prior written approval, which shall be at PI's sole discretion.

Article 17 . (Manufacturing Equipment)

17.1 SUPPLIER shall keep the Varian Model Kestrel II 750 MeV implanter located in X-FAB [*]'s facility in operating condition and available for VOLUME PRODUCTION during the Term of this Agreement as long as wafers are produced for PI at the X-FAB [*] facility in [*]. SUPPLIER shall be responsible for the maintenance and operation of this implanter. SUPPLIER will pay for all repairs of this implanter. Any repairs should be completed in reasonable time provided, however, that if a repair cannot be completed within ten (10) calendar days from discovery of the need for such repair, then SUPPLIER shall give immediate written notice to PI describing (1) the problem preventing repair in such ten (10) day period, and (2) a firm schedule for completing the repair.

17.2 SUPPLIER has purchased (1) the following manufacturing equipment, which is an [*] machine (“[*]”): [*] Machine / Model: [*]; (2) installation of the [*]; and (3) fitting for [*] & [*].

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17.3 SUPPLIER will own the [*] and, except as set forth above, will be responsible for full installation, connection to existing equipment, testing and qualification of the [*] at SUPPLIER's facility. Qualification will be in accordance with a qualification plan mutually agreed upon in writing between SUPPLIER and PI. Qualification shall not be complete until the date PI reasonably agrees in writing that the foregoing qualification plan has been met.

17.4 SUPPLIER shall keep the [*] in operating condition and available for VOLUME PRODUCTION during the Term of this Agreement. SUPPLIER shall be responsible for the maintenance and operation of the [*] as long as wafers are produced for PI at X−FAB [*]'s facility in [*]. SUPPLIER will pay for all repairs of the [*]. Any repairs should be completed in reasonable time provided, however, that if a repair cannot be completed within [*] calendar days from discovery of the need for such repair, then SUPPLIER shall give immediate written notice to PI describing (1) the problem preventing repair in such [*] day period, and (2) a firm schedule for completing the repair.

17.5 SUPPLIER shall not modify the [*] without the prior written approval of PI. SUPPLIER will pay for any modifications of the [*]. PI shall determine whether the approved modification requires re-qualification of the [*]. SUPPLIER agrees to re-qualify the [*] if so determined in accordance with a mutually agreed-to, written qualification plan. Such re-qualification will be at SUPPLIER's expense.

17.6 Without PI's prior written consent, SUPPLIER shall not (a) move or relocate the [*], (b) lend or transfer it to any third party, or (c) encumber the [*] with any lien or other security interest, except for the terms and conditions of any grant by the [*] government.

17.7 The [*] will be used for manufacturing WAFERS for PI, and for PI research and development activities. The [*] will not be used for the benefit of competitors of PI. SUPPLIER will obtain prior written consent of PI for the use of the [*] for third parties. Such consent will not unreasonably be withheld. The operation of the [*] for any other use is permitted as long as delivery and FOUNDRY CAPACITY commitments by SUPPLIER to PI are met.

17.8 SUPPLIER will maintain, at its sole cost and expense, the same types and amounts of insurance for the [*] as SUPPLIER maintains for its other similar equipment at SUPPLIER's facility. A Certificate of Insurance indicating such coverage shall be delivered to PI upon request. The Certificate shall indicate that the policy will not be changed or terminated without at least thirty (30) days' prior notice to PI, shall name PI as an additional named insured and shall also indicate that the insurer has waived its subrogation rights against PI.

17.9 SUPPLIER hereby grants a security interest in the [*] furnished hereunder and the proceeds therefrom, to secure full re-payment of the [*] COST to PI in accordance with this Agreement. SUPPLIER agrees to execute any financing statements or other documents PI requests to protect its security interest.

17.10 The requirements of Sections 17.3 - 17.7 will expire upon the earlier of the date that SUPPLIER delivers and PI accepts the Rebate Number of Wafers or upon the date that PI is paid the total amount set forth in Section 10.3.

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Article 18. (Miscellaneous Provisions)

18.1 Entire Agreement . This Agreement embodies the entire understanding of the parties as it relates to the subject matter hereof commencing as of the EFFECTIVE DATE and this Agreement supersedes any prior agreements or understandings between the parties with respect to such subject matter. For the avoidance of doubt, (1) this AGREEMENT does not supersede or replace the PRIOR AGREEMENTS and (2) all POs and information exchanged after the EFFECTIVE DATE will be governed by the terms and conditions of this AGREEMENT, and not the PRIOR AGREEMENTS.

18.2 Article Headings . The article and section headings herein are for convenience only and shall not affect the construction hereof.

18.3 Waiver . Should either PI or SUPPLIER fail to enforce any provision of this Agreement or to exercise any right in respect thereto, such failure shall not be construed as constituting a waiver or a continuing waiver of its rights to enforce such provision or right or any other provision or right.

18.4 No License . Nothing contained in this Agreement shall be construed as conferring by implication, estoppel or otherwise upon either party hereunder any license or other right except as expressly set forth in Article 4 ("INTELLECTUAL PROPERTY RIGHTS").

18.5 English Language . This Agreement is in the English language only, which language shall be controlling in all respects, and all versions hereof in any other language shall be for accommodation only and shall not be binding upon the parties. All communications between SUPPLIER and PI to effect the terms of this Agreement shall be in the English language only.

18.6 No Agency . The parties to this Agreement are independent contractors. There is no relationship of agency, partnership, joint venture, employment or franchise between the parties. Neither party has, nor will either party represent that it has, the authority to bind the other or to incur any obligation on its behalf.

18.7 Notices . Any notice required or permitted to be given by either party to the other party under this Agreement shall be in writing and delivered by overnight courier, signature of receipt required, and shall be deemed delivered upon written confirmation of delivery by the courier, if sent to the following respective addresses or such new addresses as may from time to time be supplied hereunder.

To: X-FAB Semiconductor Foundries AG

Haarbergstrasse 67

99097 Erfurt / Germany

Attention: Chief Operating Officer

To: Power Integrations, Singapore Pte Ltd

51 Newton Road,

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#15-08/10 Goldhill Plaza

Singapore, 308900

Attention: Managing Director

18.8 Invalidity . If any provision of this Agreement, or the application thereof to any situation or circumstance, shall be invalid or unenforceable, the remainder of this Agreement or the application of such provision to situations or circumstances other than those as to which it is invalid or unenforceable, shall not be affected; and each remaining provision of this Agreement shall be valid and enforceable to the fullest extent permitted by applicable law. In the event of such partial invalidity, the parties shall seek in good faith to agree on replacing any such legally invalid provisions with provisions which, in effect, will most nearly and fairly approach the effect of the invalid provision.

18.9 Assignment . This Agreement and any rights or licenses granted herein shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns. SUPPLIER shall not assign any of its rights or privileges hereunder without the prior written consent of PI except as set forth in Section 13.5. Such consent shall not be unreasonably withheld.

18.10 Amendment . This Agreement may not be extended, supplemented or amended in any manner except by an instrument in writing expressly referring to this Agreement and duly executed by authorized officers of both parties.

18.11 Force Majeure . Either party shall be excused for failures and delays in performance caused by war, declared or not, any laws, proclamations, ordinances or regulations of the government of any country or of any political subdivision of any country, or strikes, lockouts, floods, fires, explosions, acts of terrorism or such other catastrophes as are beyond the control or without the material fault of such party ("Causes"). Any party claiming any such excuse for failure or delay in performance due to such Causes shall give prompt notice thereof to the other party, and neither party shall be required to perform hereunder during the period of such excused failure or delay in performance except as otherwise provided herein. This provision shall not, however, release such party from using its best efforts to avoid or remove all such Causes and such party shall continue performance hereunder with the utmost dispatch whenever such Causes are removed. In the event that the period of excused performance continues for ninety (90) days, this Agreement may be terminated by the party not excused under this Section 18.11 ("Force Majeure"), by written notice to the other party, subject to the provisions of Article 13 ("Term and Termination") relating to the effect of termination.

18.12 Equitable Relief . Because SUPPLIER will have access to and become acquainted with the CONFIDENTIAL INFORMATION of PI, the unauthorized use or disclosure of which would cause irreparable harm and significant injury which would be difficult to ascertain and which would not be compensable by damages alone, the parties agree that PI will have the right to obtain an injunction, specific performance, or other equitable relief without prejudice to any other rights and remedies that it may have for such breach of this Agreement.

18.13 [*]

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18.14 Governing Law . This Agreement and matters connected with the performance hereof shall be construed, interpreted, applied and governed in all respects in accordance with the laws of California and the United States without regard to conflict of laws principles. SUPPLIER hereby submits to the jurisdiction of, and waives any venue objection against, the Superior Court of the State of California in Santa Clara County, or the Municipal Court of the State of California, County of Santa Clara, or the United States District Court for the Northern District of California, in any litigation arising out of this Agreement. To the extent permissible under applicable law, ea ch party to the contract hereby irrevocably waives its right to apply for a jury trial.

18.15 [*] Inch Wafers . This Agreement covers PI's acquisition of wafer fabrication and supply services from SUPPLIER based on [*]”) WAFERS. It is recognized by the parties that this Agreement shall not apply to the development and manufacture of [*]”) WAFERS. After the technical feasibility of the [*]”) WAFER process has been verified at PI's other supplier, the parties agree to negotiate in good faith regarding PI's potential acquisition of additional WAFER fabrication and supply services for [*]”) WAFERS from SUPPLIER's X-FAB [*] facility.

18.16. X-FAB [*]. SUPPLIER shall use its best efforts to qualify PI's process and supply [*] inch [*], [*] and [*] WAFERS from SUPPLIER's X-FAB [*] facility as soon as practicable after the Effective Date. PI will pay SUPPLIER a fee of U.S. [*] for SUPPLIER's research and development efforts to transfer and qualify [*], [*] and [*] WAFERS processes at X-FAB [*]. Provided SUPPLIER continues to use its best efforts to transfer and qualify such processes, PI will make such payment in accordance with the following schedule at the beginning of each year: [*].

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed in their respective corporate names by their duly authorized representatives on the date written below.

X-FAB Semiconductor Foundries AG			Power Integrations International, Ltd.
Signature:	/s/ Charles Hage	Signature:	/s/ John L. Tomlin
Name:	Charles Hage	Name:	John L. Tomlin
Title:	Vice President of Sales	Title:	President and Director
Date:	February 10, 2012	Date:	3/5/2012

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Exhibit A

SUPPLIER FOUNDRY CAPACITY AND PI ANNUAL FORECAST

1. PI's projected PI ANNUAL FORECAST of WAFER orders

The table below summarizes the PI ANNUAL FORECAST for the next five years.

Calendar Year	2011	2012	2013	2014	2015 and beyond
X-FAB [*] **WAFERS**	[*]	[*]	[*]	[*]	[*]
X-FAB [*] **WAFERS**	[*]	[*]	[*]	[*]	[*]

2. X-FABs projected MAXIMUM FOUNDRY CAPACITY of wafers for the PI PROCESS

Calendar Year	2011	2012	2013	2014	2015 and beyond
X-FAB [*] **WAFERS**	[*]	[*]	[*]	[*]	[*]
X-FAB [*] **WAFERS (projected capacity)**	[*]	[*]	[*]	[*]	[*]

The weekly MAXIMUM FOUNDRY CAPACITY can be derived from the above table which defines the annual MAXIMUM FOUNDRY CAPACITY

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Exhibit B

PRICES for X-FAB [*] WAFERS

[*] Inch [*] PROCESS WAFER

Price: [*] layers less than [*] $[*]/WAFER
[*] $[*]/WAFER
[*] $[*]/WAFER
[*] $[*]/WAFER
[*]+ $[*]/WAFER

Pricing is commensurate with monthly WAFER volume and can be adjusted if average monthly WAFER volume changes.

Any increase or decrease to raw material costs may result in an adjustment of the pricing which will be renegotiated in good faith upon the parties.

Delivery times: [*] days / layer

[*] PROCESS ENGINEERING WAFER

Price: Std. and non-std. run $[*] / wafer
[*] Wafer lot incl. [*] split $[*]
[*] Wafer lot incl. [*] splits $[*]
[*] Wafer lot incl. [*] splits $[*]
[*] Wafer lot incl. [*] splits $[*]

Hot run $[*] / wafer
Minimum wafer lot size [*] wafers

Delivery times:

Standard run [*]days / layer
Hot run [*] days / layer
Non-Standard run Mutually agreed upon order

MASK TOOLING SET

Price: [*] mask set

([*] [*]x masks)
([*] [*]x masks) $[*]

Individual masks

[*]x mask $[*] / mask
[*]x mask $[*] / mask

Vendors: Photronics Photo Masks [*], [*]
[*], [*]

THE ABOVE PRICES ARE FOR ALL POs SUBMITTED AFTER THE EFFECTIVE DATE. ALL

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PRICES ABOVE FOR EACH SUBSEQUENT YEAR WILL BE NEGOTIATED IN THE FOURTH QUARTER OF THE THEN-CURRENT CALENDAR YEAR BEGINNING IN 2011 AND PAID IN US DOLLARS. IF THE PARTIES ARE UNABLE TO AGREE ON PRICING FOR A SUBSEQUENT YEAR PRIOR TO THE END OF THE FOURTH QUARTER OF THE THEN-CURRENT CALENDAR YEAR, THEN THE PRICING FROM THE THEN-CURRENT CALENDAR YEAR WILL APPLY FOR SUCH SUBSEQUENT YEAR.

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PRICES for X-FAB [*] WAFERS

[*] Inch [*] PROCESS WAFERS

The following table contains the production pricing and volume for [*] WAFERS. [*] WAFER pricing is [*]%) higher. [*] WAFER pricing will be mutually agreed upon by the parties. The following pricing assumes any shipping, insurance and customs charges are to be borne by PI.

Year	wspm	Price
2011	[*]	$[*]
2012	[*]	$[*]
2013	[*]	$[*]
2014	[*]	$[*]
2015	[*]	$[*]
2016	[*]	$[*]
2017	[*]	$[*]
2018	[*]	$[*]
2019	[*]	$[*]
2020	[*]	$[*]

Any increase or decrease to raw material costs may result in an adjustment of the pricing which will be renegotiated in good faith upon the parties.

Delivery times: [*] days / layer

[*] PROCESS ENGINEERING WAFER

Price: Std. and non-std. run $[*]/wafer
Hot run $[*]/wafer
Minimum wafer lot size [*] wafers

Delivery times:
Standard run [*] days / layer
Hot run [*] days / layer
Non-Standard run Mutually agreed upon order

MASK TOOLING SET

Price: [*] mask set [*]x masks) $[*]
Individual [*]x masks $[*] / mask

Vendors: TBD

[*] and [*] Engineering WAFER pricing will be mutually

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Exhibit 10.3

CREDIT AGREEMENT

THIS CREDIT AGREEMENT (this "Agreement") is entered into as of February 22, 2011, by and between POWER INTEGRATIONS, INC., a Delaware corporation ("Borrower"), and WELLS FARGO BANK, NATIONAL ASSOCIATION ("Bank").

RECITALS

Borrower has requested that Bank extend or continue credit to Borrower as described below, and Bank has agreed to provide such credit to Borrower on the terms and conditions contained herein.

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Bank and Borrower hereby agree as follows:

ARTICLE I
CREDIT TERMS

SECTION 1.1. LINE OF CREDIT.

(a) Line of Credit . Subject to the terms and conditions of this Agreement, Bank hereby agrees to make advances to Borrower from time to time up to and including February 1, 2013, not to exceed at any time the aggregate principal amount of Fifty Million Dollars ($50,000,000.00) ("Line of Credit"), the proceeds of which shall be used for Borrower's general corporate purposes. Borrower's obligation to repay advances under the Line of Credit shall be evidenced by a promissory note dated as of February 22, 2011 ("Line of Credit Note"), all terms of which are incorporated herein by this reference.

(b) Letter of Credit Subfeature . As a subfeature under the Line of Credit, Bank agrees from time to time during the term thereof to issue or cause an affiliate to issue commercial and standby letters of credit for the account of Borrower to back performance (each, a "Letter of Credit" and collectively, "Letters of Credit"); provided however, that the aggregate undrawn amount of all outstanding Letters of Credit shall not at any time exceed Five Million Dollars ($5,000,000.00). Unless cash secured to Bank's satisfaction, no Letter of Credit shall have an expiration date subsequent to the maturity date of the Line of Credit. The undrawn amount of all Letters of Credit shall be reserved under the Line of Credit and shall not be available for borrowings thereunder. Each Letter of Credit shall be subject to the additional terms and conditions of the Letter of Credit agreements, applications and any related documents required by Bank in connection with the issuance thereof. Each drawing paid under a Letter of Credit shall be deemed an advance under the Line of Credit and shall be repaid by Borrower in accordance with the terms and conditions of this Agreement applicable to such advances; provided however, that if advances under the Line of Credit are not available, for any reason, at the time any drawing is paid, then Borrower shall immediately pay to Bank the full amount drawn, together with interest thereon from the date such drawing is paid to the date such amount is fully repaid by Borrower, at the rate of interest applicable to advances under the Line of Credit. In such event Borrower agrees that Bank, in its sole discretion, may debit any account maintained by Borrower with Bank for the amount of any such drawing.

(c) Borrowing and Repayment . Borrower may from time to time during the term of the Line of Credit borrow, partially or wholly repay its outstanding borrowings, and reborrow, subject to all of the limitations, terms and conditions contained herein or in the Line of Credit Note; provided however, that the total outstanding borrowings under the Line of Credit shall not at any time exceed the maximum principal amount available thereunder, as set forth above. Borrower may terminate this Agreement at any time upon notice to Bank and payment in full of all amounts owing by Borrower to Bank under this

Agreement, and cash collateralization to Bank's satisfaction of any Letters of Credit issued pursuant to this Agreement.

SECTION 1.2. INTEREST/FEES.

(a) Interest . The outstanding principal balance of each credit subject hereto shall bear interest, and the amount of each drawing paid under the Standby Letter of Credit shall bear interest from the date such drawing is paid to the date such amount is fully repaid by Borrower, at the rate of interest set forth in each promissory note or other instrument or document executed in connection therewith.

(b) Computation and Payment . Interest shall be computed on the basis of a 360-day year, actual days elapsed. Interest shall be payable at the times and place set forth in each promissory note or other instrument or document required hereby.

(c) Standby and Commercial Letter of Credit Fees . Borrower shall pay to Bank (i) fees upon the issuance of each Standby and Commercial Letter of Credit equal to one and one-half percent (1.50%) per annum (computed on the basis of a 360-day year, actual days elapsed) of the face amount thereof, and (ii) fees upon the payment or negotiation of each drawing under any Standby and Commercial Letter of Credit and fees upon the occurrence of any other activity with respect to any Standby and Commercial Letter of Credit (including without limitation, the transfer, amendment or cancellation of any Standby and Commercial Letter of Credit) determined in accordance with Bank's standard fees and charges then in effect for such activity.

(d) Commitment Termination . At any time (i) there is no outstanding principal balance or unpaid interest under the Line of Credit or the Letter of Credit subfeature described in Section 1.1(b) above, (ii) there are no issued and outstanding Letter(s) of Credit under the Letter of Credit subfeature, and (iii) there are no other payment obligations of Borrower to Bank outstanding hereunder or under any other Loan Document, then Borrower, upon written notice (a “Commitment Termination Notice”) to Bank, may request that the Line of Credit be terminated with no prepayment fees.

SECTION 1.3. DEPOSIT BALANCES ARRANGEMENT. Borrower shall maintain with Bank deposit balances, calculated on a quarterly basis, equal to $25,000,000.00 (“Deposit Balances Arrangement”). To the extent such Deposit Balances Arrangement is not maintained, Borrower shall pay to Bank a fee equal to the product of the balance deficiency multiplied by a rate per annum of 0.35%, which fee shall be calculated on a quarterly basis by Bank and shall be due and payable by Borrower in arrears within ten (10) days after each billing is sent by Bank.

SECTION 1.4. GUARANTIES. The payment and performance of all indebtedness and other obligations of Borrower to Bank shall be guaranteed jointly and severally by any current or hereafter created domestic subsidiaries of Borrower, as evidenced by and subject to the terms of guaranties in form and substance satisfactory to Bank.

ARTICLE II
REPRESENTATIONS AND WARRANTIES

Borrower makes the following representations and warranties to Bank:

SECTION 2.1. LEGAL STATUS. Borrower is a corporation, duly organized and existing and in good standing under the laws of Delaware, and is qualified or licensed to do business (and is in good standing as a foreign corporation, if applicable) in all jurisdictions in which such qualification or licensing is required, except in those states in which the failure to so qualify or to be so licensed could not reasonably be expected to have a material adverse effect on Borrower.

SECTION 2.2. AUTHORIZATION AND VALIDITY. This Agreement and each promissory note, contract, instrument and other document required hereby or at any time hereafter delivered to Bank in connection herewith (collectively, the "Loan Documents") have been duly authorized, and upon their execution and delivery in accordance with the provisions hereof will constitute legal, valid and binding agreements and obligations of Borrower or the party which executes the same, as applicable, enforceable in accordance with their respective terms.

SECTION 2.3. NO VIOLATION. The execution, delivery and performance by Borrower of each of the Loan Documents do not violate any provision of any law or regulation, or contravene any provision of the Certificate of Incorporation or By-Laws of Borrower, or result in any breach of or default under any contract, obligation, indenture or other instrument to which Borrower is a party or by which Borrower may be bound, except where such violation, contravention, breach or default would not reasonably be expected to have a material adverse effect on Borrower.

SECTION 2.4. LITIGATION. There are no pending, or to Borrower's knowledge threatened in writing, actions, claims, investigations, suits or proceedings by or before any governmental authority, arbitrator, court or administrative agency involving more than $1,000,000 individually, or $10,000,000 in the aggregate, or which would reasonably be expected to have a material adverse effect on the financial condition or operation of Borrower other than those disclosed by Borrower to Bank in writing or in Borrower's periodic and other reports, proxy statements and other materials filed with the SEC or distributed to its stockholders (the “SEC Filings”) prior to the date hereof. As used in this Agreement, “SEC” shall mean the Securities and Exchange Commission, any entity succeeding to any or all of the functions of the Securities and Exchange Commission or any national securities exchange or analogous agency, authority, instrumentality, regulatory body, court or other entity.

SECTION 2.5. CORRECTNESS OF FINANCIAL STATEMENT. The annual financial statement of Borrower dated December 31, 2009, and all interim financial statements delivered to Bank since said date, true copies of which have been delivered by Borrower to Bank prior to the date hereof, (a) are complete and correct in all material aspects and present fairly the financial condition of Borrower, (b) disclose all liabilities of Borrower that are required to be reflected or reserved against under generally accepted accounting principles, whether liquidated or unliquidated, fixed or contingent, and (c) have been prepared in accordance with generally accepted accounting principles consistently applied. Other than for Permitted Liens, Borrower has not mortgaged, pledged, granted a security interest in or otherwise encumbered any of its assets or properties except in favor of Bank or as otherwise permitted by Bank in writing. As used in this Agreement, “Permitted Liens” shall mean (i) Liens for taxes or other governmental or regulatory assessments which are not delinquent, or which are contested in good faith by the appropriate proceedings, and for which appropriate reserves are maintained in accordance with GAAP; (ii) Liens on any property held or acquired by Borrower securing indebtedness not to exceed the amounts set forth in Section 5.2(c) below incurred or assumed for the purpose of financing all or any part of the cost of acquiring such property or existing on such property when acquired; (iii) liens arising from judgments, decrees or attachments in circumstances not constituting an Event of Default (iv) liens and setoff rights in favor of other financial institutions arising in connection with Borrower's deposit accounts held at such institutions, provided the existence of such accounts does not conflict with the provisions of Section 4.9(c) hereof, (v) liens incurred or deposits made in the ordinary course of business in connection with workers' compensation, unemployment insurance and other types of social security, (vi) liens incurred or deposits made in the ordinary course of business with utility companies, (vii) liens incurred or deposits or pledges made to secure the performance of bids, tenders, contracts (other than contracts for the payment of money), public or statutory or regulatory obligations, surety, stay, appeal, indemnity, performance or other similar bonds, leases, government contracts, trade contracts, performance and return-of-money bonds and other similar obligations arising in the ordinary course of business (viii) materialmen's, landlord's, mechanics', repairmen's, workmen's, employees' or other like liens arising in the ordinary course of business, (ix) non-exclusive license of intellectual property granted to third parties in the ordinary course of business, and licenses of intellectual property that could not result in a legal transfer of title of the licensed property that may be exclusive in respects other than territory and that may be exclusive as to territory only as to discrete geographical areas outside of the United States, (x) liens on insurance proceeds in favor of insurance companies granted solely as security for financed premiums, (xi) easements, reservations, rights-of-way, minor defects or irregularities in title and other similar charges or encumbrances affecting real property, and (xii) any interest or title of a lessor or sub-lessor under any lease of real property in the ordinary course of business.

SECTION 2.6. INCOME TAX RETURNS. Borrower has no knowledge of any pending assessments or adjustments of its income tax payable with respect to any year as disclosed in SEC reporting.

SECTION 2.7. NO SUBORDINATION. There is no agreement, indenture, contract or instrument to which Borrower is a party or by which Borrower may be bound that requires the subordination in right of payment of any of Borrower's obligations subject to this Agreement to any other obligation of Borrower.

SECTION 2.8. PERMITS, FRANCHISES. Borrower possesses, and will hereafter possess, all permits, consents, approvals, franchises and licenses required and rights to all trademarks, trade names, patents, and fictitious names, if any, necessary to enable it to conduct the business in which it is now engaged in compliance with applicable law.

SECTION 2.9. ERISA. Borrower is in compliance in all material respects with all applicable provisions of the Employee Retirement Income Security Act of 1974, as amended or recodified from time to time ("ERISA"); Borrower has not violated any provision of any defined employee pension benefit plan (as defined in ERISA) maintained or contributed to by Borrower (each, a "Plan"); no Reportable Event as defined in ERISA has occurred and is continuing with respect to any Plan initiated by Borrower; Borrower has met its minimum funding requirements under ERISA with respect to each Plan; and each Plan will be able to fulfill its benefit obligations as they come due in accordance with the Plan documents and under generally accepted accounting principles.

SECTION 2.10. OTHER OBLIGATIONS. Borrower is not in default on any obligation for borrowed money, any purchase money obligation or any other material lease, commitment, contract, instrument or obligation, in each case under any agreements involving monetary liability, which default or defaults result in a right by such third party or parties, whether or not exercised, to accelerate the maturity of any indebtedness in excess of Five Million Dollars ($5,000,000).

SECTION 2.11. ENVIRONMENTAL MATTERS. Except as disclosed by Borrower to Bank in writing prior to the date hereof, Borrower is in compliance in all material respects with all applicable federal or state environmental, hazardous waste, health and safety statutes, and any rules or regulations adopted pursuant thereto, which govern or affect any of Borrower's operations and/or properties, including without limitation, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Superfund Amendments and Reauthorization Act of 1986, the Federal Resource Conservation and Recovery Act of 1976, and the Federal Toxic Substances Control Act, as any of the same may be amended, modified or supplemented from time to time. None of the operations of Borrower is the subject of any federal or state investigation evaluating whether any remedial action involving a material expenditure is needed to respond to a release of any toxic or hazardous waste or substance into the environment. Borrower has no material contingent liability in connection with any release of any toxic or hazardous waste or substance into the environment.

ARTICLE III
CONDITIONS

SECTION 3.1. CONDITIONS OF INITIAL EXTENSION OF CREDIT. The obligation of Bank to extend any credit contemplated by this Agreement is subject to the fulfillment to Bank's satisfaction of all of the following conditions:

(a) Approval of Bank Counsel . All legal matters incidental to the extension of credit by Bank shall be satisfactory to Bank's counsel.

(b) Documentation . Bank shall have received, in form and substance satisfactory to Bank, each of the following, duly executed:

(i) This Agreement and each promissory note or other instrument or document required hereby.
(ii) Corporate Resolution: Borrowing.
(iii) Certificate of Incumbency.
(iv) Disbursement Order.
(v) Such other documents as Bank may require under any other Section of this Agreement.

(c) Financial Condition . There shall have been no material adverse change, as determined by Bank, in the financial condition or business of Borrower or any guarantor hereunder, nor any material decline, as determined by Bank, in the market value of any collateral required hereunder or a substantial or material portion of the assets of Borrower or any such guarantor.

(d) Insurance . Borrower shall have delivered to Bank evidence of insurance coverage on all Borrower's property, in form, substance, amounts, covering risks and issued by companies satisfactory to Bank, and where required by Bank, with loss payable endorsements in favor of Bank.

SECTION 3.2. CONDITIONS OF EACH EXTENSION OF CREDIT. The obligation of Bank to make each extension of credit requested by Borrower hereunder shall be subject to the fulfillment to Bank's satisfaction of each of the following conditions:

(a) Compliance . The representations and warranties contained herein and in each of the other Loan Documents shall be true on and as of the date of the signing of this Agreement and, except as disclosed to Bank or in the SEC Filings, on the date of each extension of credit by Bank pursuant hereto, with the same effect as though such representations and warranties had been made on and as of each such date, and on each such date, no Event of Default as defined herein, and no condition, event or act which with the giving of notice or the passage of time or both would constitute such an Event of Default, shall have occurred and be continuing or shall exist.

(b) Documentation . Bank shall have received all additional documents which may be required in connection with such extension of credit.

(c) Additional Letter of Credit Documentation. Prior to the issuance of each Letter of Credit, Bank shall have received a Letter of Credit Agreement on Bank's standard form, properly completed and duly executed by Borrower.

(d) No Material Adverse Change. There shall not exist or have occurred any event or condition that impairs, or is substantially to impair, the prospect of payment or performance by Borrower of its obligations under any of the Loan Documents.

ARTICLE IV
AFFIRMATIVE COVENANTS

Borrower covenants that so long as Bank remains committed to extend credit to Borrower pursuant hereto, or any liabilities (whether direct or contingent, liquidated or unliquidated) of Borrower to Bank under any of the Loan Documents remain outstanding, and until payment in full of all obligations of Borrower subject hereto, Borrower shall, unless Bank otherwise consents in writing:

SECTION 4.1. PUNCTUAL PAYMENTS. Within seven (7) days after such obligations are due and payable, pay all principal, interest, fees or other liabilities due under any of the Loan Documents at the times and place and in the manner specified therein.

SECTION 4.2. ACCOUNTING RECORDS. Maintain adequate books and records in accordance with generally accepted accounting principles consistently applied, and permit any representative of Bank, at any reasonable time, to inspect, audit and examine such books and records, to make copies of the same, and to inspect the properties of Borrower.

SECTION 4.3. FINANCIAL STATEMENTS. Provide to Bank all of the following, in form and detail satisfactory to Bank:

(a) not later than 120 days after and as of the end of each fiscal year, an audited financial statement of Borrower, prepared by a certified public accountant acceptable to Bank, to include balance sheet, income statement, and statement of cash flow;

(b) not later than 45 days after and as of the end of each fiscal quarter, a financial statement of Borrower, prepared by Borrower, to include balance sheet, income statement, and statement of cash flow;

(c) not later than 90 days after the end of each fiscal year, an annual budget and projection report, prepared by Borrower;

(d) contemporaneously with each fiscal quarter financial statement of Borrower required hereby, and concurrently with the submission of each advance request under the Line of Credit, a certificate of the president or chief financial officer of Borrower that said financial statements are accurate and that there exists no Event of Default nor any condition, act or event which with the giving of notice or the passage of time or both would constitute an Event of Default;

(e) from time to time such other information as Bank may reasonably request.

SECTION 4.4. COMPLIANCE. Preserve and maintain all licenses, permits, governmental approvals, rights, privileges and franchises necessary for the conduct of its business; and comply with the provisions of all documents pursuant to which Borrower is organized and/or which govern Borrower's continued existence and with the requirements of all laws, rules, regulations and orders of any governmental authority applicable to Borrower and/or its business, the noncompliance with or violation of which could reasonably be expected to have a material adverse effect on Borrower's business.

SECTION 4.5. INSURANCE. Maintain and keep in force, for each business in which Borrower is engaged, insurance of the types and in amounts customarily carried in similar lines of business, including but not limited to fire, extended coverage, public liability, flood, property damage and workers' compensation, with all such insurance carried with companies and in amounts satisfactory to Bank, and deliver to Bank from time to time at Bank's request schedules setting forth all insurance then in effect.

SECTION 4.6. FACILITIES. Keep all properties necessary to Borrower's business in good repair and condition, and from time to time make necessary repairs, renewals and replacements thereto so that such properties shall be fully and efficiently preserved and maintained.

SECTION 4.7. TAXES AND OTHER LIABILITIES. Pay and discharge when due any and all indebtedness, obligations, assessments and taxes, both real or personal, including without limitation federal and state income taxes and state and local property taxes and assessments, except (a) such as Borrower may in good faith contest or as to which a bona fide dispute may arise, and (b) for which Borrower has made provision with adequate reserves under GAAP for eventual payment thereof in the event Borrower is obligated to make such payment.

SECTION 4.8. LITIGATION. Except as disclosed in Borrower's SEC Filings, promptly give notice in writing to Bank of any litigation pending or threatened in writing against Borrower involving more than $1,000,000 individually, or $10,000,000 in the aggregate.

SECTION 4.9. FINANCIAL CONDITION. Maintain Borrower's financial condition as follows using generally accepted accounting principles consistently applied and used consistently with prior practices (except to the extent modified by the definitions herein):

(a) Modified Quick Ratio not less than 1.50 to 1.0 at all times, measured on a consolidated basis at each fiscal quarter end, with "Modified Quick Ratio" defined as the aggregate of unrestricted cash, unrestricted marketable securities, net accounts receivable, and long term investments divided by total current liabilities and borrowings under the Line of Credit.

(b) Tangible Net Worth measured on a consolidated basis at each fiscal quarter end, not less than $200,000,000 less than Borrower's actual Tangible Net Worth at Borrower's fiscal year ending 2010, with "Tangible Net Worth" defined as the aggregate of total stockholders' equity [plus subordinated debt] less any intangible assets [and less any loans or advances to, or investments in, any related entities or individuals].

(c) Maintain Borrower's primary collection and disbursement deposit account(s) with Bank or any banking affiliate of Bank. The transition will begin within 30 days of closing and will be completed by June 30, 2011.

SECTION 4.10. NOTICE TO BANK. Promptly (but in no event more than five (5) days after the occurrence of each such event or matter) give written notice to Bank in reasonable detail of: (a) the occurrence of any Event of Default, or any condition, event or act which with the giving of notice or the passage of time or both would constitute an Event of Default; (b) any change in the name or the organizational structure of Borrower; (c) the occurrence and nature of any Reportable Event or Prohibited Transaction, each as defined in ERISA, or any funding deficiency with respect to any Plan; or (d) any termination or cancellation of any insurance policy which Borrower is required to maintain, or any uninsured or partially uninsured loss through liability or property damage, or through fire, theft or any other cause affecting Borrower's property.

ARTICLE V
NEGATIVE COVENANTS

Borrower further covenants that so long as Bank remains committed to extend credit to Borrower pursuant hereto, or any liabilities (whether direct or contingent, liquidated or unliquidated, but excluding inchoate indemnity obligations) of Borrower to Bank under any of the Loan Documents remain outstanding, and until payment in full of all obligations (other than inchoate indemnity obligations) of Borrower subject hereto, Borrower will not without Bank's prior written consent:

SECTION 5.1. USE OF FUNDS. Use any of the proceeds of any credit extended hereunder except for the purposes stated in Article I hereof.

SECTION 5.2. OTHER INDEBTEDNESS. Create, incur, assume or permit to exist any indebtedness or liabilities resulting from borrowings, loans or advances, whether secured or unsecured, matured or unmatured, liquidated or unliquidated, joint or several, except (a) the liabilities of Borrower to Bank, (b) any other liabilities of Borrower existing as of, and disclosed to Bank prior to, the date hereof, (c) new purchase money debt and other debt in amounts not to exceed an aggregate of $5,000,000.00 during each fiscal year, (d) the issuance of unsecured, subordinated convertible debt, provided, however, that such debt is subordinated in writing on terms reasonably acceptable to Bank and that Borrower is in proforma compliance with financial covenants both pre and post issuance of debt, (e) indebtedness to trade creditors incurred in the ordinary course of business, (f) indebtedness incurred as a result of endorsing negotiable instruments received in the ordinary course of business, (g) indebtedness secured by Permitted Liens, (h) indebtedness between Borrower and its subsidiaries in the ordinary course of business, and (h) extensions, refinancings, modifications and restatements of the foregoing provided that the principal amount thereof is not increased or the terms thereof are not modified to impose more burdensome terms.

SECTION 5.3. MERGER, CONSOLIDATION, TRANSFER OF ASSETS. Borrower may enter into mergers or acquisitions with, and make loans or advances to and equity investments in, and sell, lease or transfer assets to third party entities so long as Borrower is the surviving entity (as applicable) and Borrower is in pro forma compliance with financial covenants both before and after each such merger, consolidation, acquisition, loan, advance, equity investment, sale, lease or transfer of assets.

SECTION 5.4. GUARANTIES. Guarantee or become liable in any way as surety, endorser (other than as endorser of negotiable instruments for deposit or collection in the ordinary course of business), accommodation endorser or otherwise for, nor pledge or hypothecate any assets of Borrower as security for, any liabilities or obligations of any other person or entity, except (i) any of the foregoing in favor of Bank, and (ii) in the ordinary course of Borrower's business.

SECTION 5.5. LOANS, ADVANCES, INVESTMENTS. Make any loans or advances to or investments in any person or entity, except (a) any of the foregoing existing as of, and disclosed to Bank prior to, the date hereof, (b) any of the foregoing in accordance with the provisions of Section 5.3 above, (c) additional loans, advances or investments in or to Borrower's subsidiaries in the ordinary course of business, or (d) investments made pursuant to a Board-approved investment policy.

SECTION 5.6. PLEDGE OF ASSETS. Other than for Permitted Liens, mortgage, pledge, grant or permit to exist a security interest in, or lien upon, all or any portion of Borrower's assets now owned or hereafter acquired, except any of the foregoing in favor of Bank or which is existing as of, and disclosed to Bank in writing prior to, the date hereof.

ARTICLE VI
EVENTS OF DEFAULT

SECTION 6.1. The occurrence of any of the following shall constitute an "Event of Default" under this Agreement:

(a) Borrower shall fail to pay, within seven (7) days of when due, any principal, interest, fees or other amounts payable under any of the Loan Documents (provided that such seven (7) day cure period shall not apply to payments due upon stated maturity of the Line of Credit Note and that during the cure period, the failure to make or pay any payment specified under this subclause (a) is not an Event of Default, but no credit extension will be made during the cure period).

(b) Any financial statement or certificate furnished to Bank in connection with, or any representation or warranty made by Borrower or any other party under this Agreement or any other Loan Document shall prove to be incorrect, false or misleading in any material respect when furnished or made.

(c) Any default in the performance of or compliance with any obligation, agreement or other provision contained herein or in any other Loan Document (other than those specifically described as an “Event of Default” in this Section 6.1), and with respect to any such default that by its nature can be cured, such default shall continue for a period of thirty (30) days from its occurrence.

(d) Any default in the payment or performance of any monetary obligation in excess of $5,000,000, or any defined event of default, under the terms of any contract, instrument or document (other than any of the Loan Documents) pursuant to which Borrower or any guarantor hereunder (with each such guarantor referred to herein as a "Third Party Obligor") has incurred any debt for borrowed money in an amount greater than $5,000,000.

(e) Borrower or any Third Party Obligor shall become insolvent, or shall suffer or consent to or apply for the appointment of a receiver, trustee, custodian or liquidator of itself or any of its property, or shall generally fail to pay its debts as they become due, or shall make a general assignment for the benefit of creditors; Borrower or any Third Party Obligor shall file a voluntary petition in bankruptcy, or seeking reorganization, in order to effect a plan or other arrangement with creditors or any other relief under the Bankruptcy Reform Act, Title 11 of the United States Code, as amended or recodified from time to time ("Bankruptcy Code"), or under any state or federal law granting relief to debtors, whether now or hereafter in effect; or Borrower or any Third Party Obligor shall file an answer admitting the jurisdiction of the court and the material allegations of any involuntary petition; or Borrower or any Third Party Obligor shall be adjudicated a bankrupt, or an order for relief shall be entered against Borrower or any Third Party Obligor by any court of competent jurisdiction under the Bankruptcy Code or any other applicable state or federal law relating to bankruptcy, reorganization or other relief for debtors.

(f) The filing of a notice of judgment lien against Borrower in an amount of at least $5,000,000 (not covered by independent third-party insurance as to which liability has been accepted by such insurance carrier) shall remain unsatisfied for thirty (30) days and is not discharged or stayed (whether through the posting of a bond or otherwise) within thirty (30) days; or the recording of any abstract of judgment against Borrower in an amount of at least $5,000,000 (not covered by independent third-party insurance as to which liability has been accepted by such insurance carrier) and the same is not, within thirty (30) days after the occurrence thereof, discharged or stayed (whether through the posting of a bond or otherwise) in any county in which Borrower has an interest in real property; or the service of a notice of levy and/or of a writ of attachment or execution, or other like process, against the assets of Borrower and the same is not, within thirty (30) days after the occurrence thereof, discharged or stayed (whether through the posting of a bond or otherwise); or the entry of one or more final judgments, orders, or decrees for the payment of money in an amount, individually or in the aggregate, of at least $5,000,000 (not covered by independent third-party insurance as to which liability has been accepted by such insurance carrier) shall be rendered against Borrower and the same are not, within thirty (30) days after the entry thereof, discharged or execution thereof stayed or bonded pending appeal, or such judgments are not discharged prior to the expiration of any such stay; or any involuntary petition or proceeding pursuant to the Bankruptcy Code or any other applicable state or federal law relating to bankruptcy, reorganization or other relief for debtors is filed or commenced against Borrower or any Third Party Obligor.

(g) [Intentionally Omitted].

(h) The dissolution or liquidation of Borrower or any Third Party Obligor if a corporation, partnership, joint venture or other type of entity; or Borrower or any such Third Party Obligor, or any of its directors, stockholders or members, shall take action seeking to effect the dissolution or liquidation of Borrower or such Third Party Obligor.

(i) 60 days after the occurrence of any Change in Control of Borrower, coupled with removal or departure of Balu Balakrishnan as Chief Executive Officer. All defined terms as used in this Section 6.1 are defined below.

A " *Change in Control* " means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) any Exchange Act Person becomes the Owner, directly or indirectly, of securities of the Borrower representing more than fifty percent (50%) of the combined voting power of the Borrower's then outstanding securities other than by virtue of a merger, consolidation or similar transaction. Notwithstanding the foregoing, a Change in Control shall not be deemed to occur (A) on account of the acquisition of securities of the Borrower directly from the Borrower, (B) on account of the acquisition of securities of the Borrower by an investor, any affiliate thereof or any other Exchange Act Person that acquires the Borrower's securities in a transaction or series of related transactions the primary purpose of which is to obtain financing for the Borrower through the issuance of equity securities, or (C) solely because the level of Ownership held by any Exchange Act Person (the "Subject Person") exceeds the designated percentage threshold of the outstanding voting securities as a result of a repurchase or other acquisition of voting securities by the Borrower reducing the number of shares outstanding, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of voting securities by the Borrower, and after such share acquisition, the Subject Person becomes the Owner of any additional voting securities that, assuming the repurchase or other acquisition had not occurred, increases the percentage of the then outstanding voting securities Owned by the Subject Person over the designated percentage threshold, then a Change in Control shall be deemed to occur; or

(ii) there is consummated a merger, consolidation or similar transaction involving (directly or indirectly) the Borrower and, immediately after the consummation of such merger, consolidation or similar transaction, the stockholders of the Borrower immediately prior thereto do not Own, directly or indirectly, either (A) outstanding voting securities representing more than fifty percent (50%) of the combined outstanding voting power of the surviving corporation, partnership, limited liability company or other entity in such merger, consolidation or similar transaction or (B) more than fifty percent (50%) of the combined outstanding voting power of the parent of the surviving corporation, partnership, limited liability company or other entity in such merger, consolidation or similar transaction, in each case in substantially the same proportions as their Ownership of the outstanding voting securities of the Borrower immediately prior to such transaction.

" *Exchange Act Person* " means any natural person, corporation, partnership, limited liability company or other entity, or "group" (within the meaning of Section 13(d) or 14(d) of the Securities Exchange Act of 1934 (the " *Exchange Act* ")), except that " *Exchange Act Person* " shall not include (i) the Borrower or any subsidiary of the Borrower, (ii) any employee benefit plan of the Borrower or any subsidiary of the Borrower or any trustee or other fiduciary holding securities under an employee benefit plan of the Borrower or any subsidiary of the Borrower, (iii) an underwriter temporarily holding securities pursuant to a registered public offering of such securities, (iv) a corporation, partnership, limited liability company or other entity Owned, directly or indirectly, by the stockholders of the Borrower in substantially the same proportions as their Ownership of stock of the Borrower; or (v) any natural person, corporation, partnership, limited liability company or other entity or "group" (within the meaning of Section 13(d) or 14(d) of the Exchange Act) that, as of the date hereof, is the Owner, directly or indirectly, of securities of the Borrower representing more than fifty percent (50%) of the combined voting power of the Borrower's then outstanding securities.

A person or corporation, partnership, limited liability company or other entity shall be deemed to " *Own* ," to have " *Owned* ," to be the " *Owner* " of, or to have acquired " *Ownership* " of securities if such person or corporation, partnership, limited liability company, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power, which includes the power to vote or to direct the voting, with respect to such securities.

SECTION 6.2. REMEDIES. Upon the occurrence of any Event of Default: (a) all indebtedness of Borrower under each of the Loan Documents, any term thereof to the contrary notwithstanding, shall at Bank's option and without notice become immediately due and payable without presentment, demand, protest or notice of dishonor, all of which are hereby expressly waived by Borrower; (b) the obligation, if any, of Bank to extend any further credit under any of the Loan Documents shall immediately cease and terminate; and (c) Bank shall have all rights, powers and remedies available under each of the Loan Documents, or accorded by law, including without limitation the right to resort to any or all security for any credit subject hereto and to exercise any or all of the rights of a beneficiary or secured party pursuant to applicable law. All rights, powers and remedies of Bank may be exercised at any time by Bank and from time to time after the occurrence of an Event of Default, are cumulative and not exclusive, and shall be in addition to any other rights, powers or remedies provided by law or equity.

ARTICLE VII
MISCELLANEOUS

SECTION 7.1. NO WAIVER. No delay, failure or discontinuance of Bank in exercising any right, power or remedy under any of the Loan Documents shall affect or operate as a waiver of such right, power or remedy; nor shall any single or partial exercise of any such right, power or remedy preclude, waive or otherwise affect any other or further exercise thereof or the exercise of any other right, power or remedy. Any waiver, permit, consent or approval of any kind by Bank of any breach of or default under any of the Loan Documents must be in writing and shall be effective only to the extent set forth in such writing.

SECTION 7.2. NOTICES. All notices, requests and demands which any party is required or may desire to give to any other party under any provision of this Agreement must be in writing delivered to each party at the following address:

BORROWER:	POWER INTEGRATIONS, INC. 5245 Hellyer Avenue San Jose, CA 95138
BANK:	WELLS FARGO BANK, NATIONAL ASSOCIATION Santa Clara Technology Regional Commercial Banking Office 121 S. Market Street, 2 nd Floor San Jose, CA 95113

or to such other address as any party may designate by written notice to all other parties. Each such notice, request and demand shall be deemed given or made as follows: (a) if sent by hand delivery, upon delivery; (b) if sent by mail, upon the earlier of the date of receipt or three (3) days after deposit in the U.S. mail, first class and postage prepaid; and (c) if sent by telecopy, upon receipt.

SECTION 7.3. COSTS, EXPENSES AND ATTORNEYS' FEES. Borrower shall pay to Bank immediately upon demand the full amount of all payments, advances, charges, costs and expenses, including reasonable attorneys' fees (to include outside counsel fees and all allocated costs of Bank's in-house counsel), expended or incurred by Bank in connection with (a) the negotiation and preparation of this Agreement and the other Loan Documents, Bank's continued administration hereof and thereof, and the preparation of any amendments and waivers hereto and thereto, (b) the enforcement of Bank's rights and/or the collection of any amounts which become due to Bank under any of the Loan Documents, and (c) the prosecution or defense of any action in any way related to any of the Loan Documents, including without limitation, any action for declaratory relief, whether incurred at the trial or appellate level, in an arbitration proceeding or otherwise, and including any of the foregoing incurred in connection with any bankruptcy proceeding (including without limitation, any adversary proceeding, contested matter or motion brought by Bank or any other person) relating to Borrower or any other person or entity.

SECTION 7.4. SUCCESSORS, ASSIGNMENT. This Agreement shall be binding upon and inure to the benefit of the heirs, executors, administrators, legal representatives, successors and assigns of the parties; provided however, that Borrower may not assign or transfer its interests or rights hereunder without Bank's prior written consent. Bank reserves the right to sell, assign, transfer, negotiate or grant participations in all or any part of, or any interest in, Bank's rights and benefits under each of the Loan Documents. In connection therewith, Bank may disclose all documents and information which Bank now has or may hereafter acquire relating to any credit subject hereto, Borrower or its business, any guarantor hereunder or the business of such guarantor, or any collateral required hereunder.

SECTION 7.5. ENTIRE AGREEMENT; AMENDMENT. This Agreement and the other Loan Documents constitute the entire agreement between Borrower and Bank with respect to each credit subject hereto and supersede all prior negotiations, communications, discussions and correspondence concerning the subject matter hereof. This Agreement may be amended or modified only in writing signed by each party hereto.

SECTION 7.6. NO THIRD PARTY BENEFICIARIES. This Agreement is made and entered into for the sole protection and benefit of the parties hereto and their respective permitted successors and assigns, and no other person or entity shall be a third party beneficiary of, or have any direct or indirect cause of action or claim in connection with, this Agreement or any other of the Loan Documents to which it is not a party.

SECTION 7.7. TIME. Time is of the essence of each and every provision of this Agreement and each other of the Loan Documents.

SECTION 7.8. SEVERABILITY OF PROVISIONS. If any provision of this Agreement shall be prohibited by or invalid under applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity without invalidating the remainder of such provision or any remaining provisions of this Agreement.

SECTION 7.9. COUNTERPARTS. This Agreement may be executed in any number of counterparts, each of which when executed and delivered shall be deemed to be an original, and all of which when taken together shall constitute one and the same Agreement.

SECTION 7.10. GOVERNING LAW. This Agreement shall be governed by and construed in accordance with the laws of the State of California.

SECTION 7.11. ARBITRATION.

(a) Arbitration . The parties hereto agree, upon demand by any party, to submit to binding arbitration all claims, disputes and controversies between or among them (and their respective employees, officers, directors, attorneys, and other agents), whether in tort, contract or otherwise in any way arising out of or relating to (i) any credit subject hereto, or any of the Loan Documents, and their negotiation, execution, collateralization, administration, repayment, modification, extension, substitution, formation, inducement, enforcement, default or termination; or (ii) requests for additional credit.

(b) Governing Rules . Any arbitration proceeding will (i) proceed in a location in California selected by the American Arbitration Association ("AAA"); (ii) be governed by the Federal Arbitration Act (Title 9 of the United States Code), notwithstanding any conflicting choice of law provision in any of the documents between the parties; and (iii) be conducted by the AAA, or such other administrator as the parties shall mutually agree upon, in accordance with the AAA's commercial dispute resolution procedures, unless the claim or counterclaim is at least $1,000,000.00 exclusive of claimed interest, arbitration fees and costs in which case the arbitration shall be conducted in accordance with the AAA's optional procedures for large, complex commercial disputes (the commercial dispute resolution procedures or the optional procedures for large, complex commercial disputes to be referred to herein, as applicable, as the "Rules"). If there is any inconsistency between the terms hereof and the Rules, the terms and procedures set forth herein shall control. Any party who fails or refuses to submit to arbitration following a demand by any other party shall bear all costs and expenses incurred by such other party in compelling arbitration of any dispute. Nothing contained herein shall be deemed to be a waiver by any party that is a bank of the protections afforded to it under 12 U.S.C. §91 or any similar applicable state law.

(c) No Waiver of Provisional Remedies, Self-Help and Foreclosure . The arbitration requirement does not limit the right of any party to (i) foreclose against real or personal property collateral; (ii) exercise self-help remedies relating to collateral or proceeds of collateral such as setoff or repossession; or (iii) obtain provisional or ancillary remedies such as replevin, injunctive relief, attachment or the appointment of a receiver, before during or after the pendency of any arbitration proceeding. This exclusion does not constitute a waiver of the right or obligation of any party to submit any dispute to arbitration or reference hereunder, including those arising from the exercise of the actions detailed in sections (i), (ii) and (iii) of this paragraph.

(d) Arbitrator Qualifications and Powers. Any arbitration proceeding in which the amount in controversy is $5,000,000.00 or less will be decided by a single arbitrator selected according to the Rules, and who shall not render an award of greater than $5,000,000.00. Any dispute in which the amount in controversy exceeds $5,000,000.00 shall be decided by majority vote of a panel of three arbitrators; provided however, that all three arbitrators must actively participate in all hearings and deliberations. The arbitrator will be a neutral attorney licensed in the State of California or a neutral retired judge of the state or federal judiciary of California, in either case with a minimum of ten years experience in the substantive law applicable to the subject matter of the dispute to be arbitrated. The arbitrator will determine whether or not an issue is arbitratable and will give effect to the statutes of limitation in determining any claim. In any arbitration proceeding the arbitrator will decide (by documents only or with a hearing at the arbitrator's discretion) any pre-hearing motions which are similar to motions to dismiss for failure to state a claim or motions for summary adjudication. The arbitrator shall resolve all disputes in accordance with the substantive law of California and may grant any remedy or relief that a court of such state could order or grant within the scope hereof and such ancillary relief as is necessary to make effective any award. The arbitrator shall also have the power to award recovery of all costs and fees, to impose sanctions and to take such other action as the arbitrator deems necessary to the same extent a judge could pursuant to the Federal Rules of Civil Procedure, the California Rules of Civil Procedure or other applicable law. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction. The institution and maintenance of an action for judicial relief or pursuit of a provisional or ancillary remedy shall not constitute a waiver of the right of any party, including the plaintiff, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief.

(e) Discovery. In any arbitration proceeding, discovery will be permitted in accordance with the Rules. All discovery shall be expressly limited to matters directly relevant to the dispute being arbitrated and must be completed no later than 20 days before the hearing date. Any requests for an extension of the discovery periods, or any discovery disputes, will be subject to final determination by the arbitrator upon a showing that the request for discovery is essential for the party's presentation and that no alternative means for obtaining information is available.

(f) Class Proceedings and Consolidations. No party hereto shall be entitled to join or consolidate disputes by or against others in any arbitration, except parties who have executed any Loan Document, or to include in any arbitration any dispute as a representative or member of a class, or to act in any arbitration in the interest of the general public or in a private attorney general capacity.

(g) Payment Of Arbitration Costs And Fees**.** The arbitrator shall award all costs and expenses of the arbitration proceeding.

(h) Real Property Collateral; Judicial Reference. Notwithstanding anything herein to the contrary, no dispute shall be submitted to arbitration if the dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless (i) the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration, or (ii) all parties to the arbitration waive any rights or benefits that might accrue to them by virtue of the single action rule statute of California, thereby agreeing that all indebtedness and obligations of the parties, and all mortgages, liens and security interests securing such indebtedness and obligations, shall remain fully valid and enforceable. If any such dispute is not submitted to arbitration, the dispute shall be referred to a referee in accordance with California Code of Civil Procedure Section 638 et seq., and this general reference agreement is intended to be specifically enforceable in accordance with said Section 638. A referee with the qualifications required herein for arbitrators shall be selected pursuant to the AAA's selection procedures. Judgment upon the decision rendered by a referee shall be entered in the court in which such proceeding was commenced in accordance with California Code of Civil Procedure Sections 644 and 645.

(i) Miscellaneous . To the maximum extent practicable, the AAA, the arbitrators and the parties shall take all action required to conclude any arbitration proceeding within 180 days of the filing of the dispute with the AAA. No arbitrator or other party to an arbitration proceeding may disclose the existence, content or results thereof, except for disclosures of information by a party required in the ordinary course of its business or by applicable law or regulation. If more than one agreement for arbitration by or between the parties potentially applies to a dispute, the arbitration provision most directly related to the Loan Documents or the subject matter of the dispute shall control. This arbitration provision shall survive termination, amendment or expiration of any of the Loan Documents or any relationship between the parties.

(j) Small Claims Court . Notwithstanding anything herein to the contrary, each party retains the right to pursue in Small Claims Court any dispute within that court's jurisdiction. Further, this arbitration provision shall apply only to disputes in which either party seeks to recover an amount of money (excluding attorneys' fees and costs) that exceeds the jurisdictional limit of the Small Claims Court.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the day and year first written above.

POWER INTEGRATIONS, INC.

By: /s/ Balu Balakrishnan
Balu Balakrishnan,
President & CEO

WELLS FARGO BANK,
NATIONAL ASSOCIATION

By: /s/ Greg P. Cohn
Greg P. Cohn,
Vice President

REVOLVING LINE OF CREDIT NOTE

$50,000,000.00 San Jose, California
February 22, 2011

FOR VALUE RECEIVED, the undersigned POWER INTEGRATIONS, INC. ("Borrower") promises to pay to the order of WELLS FARGO BANK, NATIONAL ASSOCIATION ("Bank") at its office at 121 S. Market Street, 2 nd Floor, San Jose, California 95113, or at such other place as the holder hereof may designate, in lawful money of the United States of America and in immediately available funds, the principal sum of Fifty Million Dollars ($50,000,000.00), or so much thereof as may be advanced and be outstanding, with interest thereon, to be computed on each advance from the date of its disbursement as set forth herein.

DEFINITIONS:

As used herein, the following terms shall have the meanings set forth after each, and any other term defined in this Note shall have the meaning set forth at the place defined:

(a) "Business Day" means any day except a Saturday, Sunday or any other day on which commercial banks in California are authorized or required by law to close.

(b) "Fixed Rate Term" means a period commencing on a Business Day and continuing for one (1), three (3), or six (6) months, as designated by Borrower, during which all or a portion of the outstanding principal balance of this Note bears interest determined in relation to LIBOR; provided however, that no Fixed Rate Term may be selected for a principal amount less than One Hundred Thousand Dollars ($100,000.00); and provided further, that no Fixed Rate Term shall extend beyond the scheduled maturity date hereof. If any Fixed Rate Term would end on a day which is not a Business Day, then such Fixed Rate Term shall be extended to the next succeeding Business Day.

(c) "LIBOR" means the rate per annum (rounded upward, if necessary, to the nearest whole 1/8 of 1%) and determined pursuant to the following formula:

$$\text{LIBOR} = \frac{\text{Base LIBOR}}{100\% - \text{LIBOR Reserve Percentage}}$$

(i) "Base LIBOR" means the rate per annum for United States dollar deposits quoted by Bank as the Inter-Bank Market Offered Rate, with the understanding that such rate is quoted by Bank for the purpose of calculating effective rates of interest for loans making reference thereto, on the first day of a Fixed Rate Term for delivery of funds on said date for a period of time approximately equal to the number of days in such Fixed Rate Term and in an amount approximately equal to the principal amount to which such Fixed Rate Term applies. Borrower understands and agrees that Bank may base its quotation of the Inter-Bank Market Offered Rate upon such offers or other market indicators of the Inter-Bank Market as Bank in its discretion deems appropriate including, but not limited to, the rate offered for U.S. dollar deposits on the London Inter-Bank Market.

(ii) "LIBOR Reserve Percentage" means the reserve percentage prescribed by the Board of Governors of the Federal Reserve System (or any successor) for "Eurocurrency Liabilities" (as defined in Regulation D of the Federal Reserve Board, as amended), adjusted by Bank for expected changes in such reserve percentage during the applicable Fixed Rate Term.

(d) "Prime Rate" means at any time the rate of interest most recently announced within Bank at its principal office as its Prime Rate, with the understanding that the Prime Rate is one of Bank's base rates and serves as the basis upon which effective rates of interest are calculated for those loans making reference thereto, and is evidenced by the recording thereof after its announcement in such internal publication or publications as Bank may designate.

INTEREST:

(a) Interest. The outstanding principal balance of this Note shall bear interest (computed on the basis of a 360-day year, actual days elapsed) either, as designated by Borrower at Borrower's option, (i) at a fluctuating rate per annum equal to the Prime Rate in effect from time to time, or (ii) at a fixed rate per annum determined by Bank to be one and one-half percent (1.50%) above LIBOR in effect on the first day of the applicable Fixed Rate Term. When interest is determined in relation to the Prime Rate, each change in the rate of interest hereunder shall become effective on the date each Prime Rate change is announced within Bank. With respect to each LIBOR selection hereunder, Bank is hereby authorized to note the date, principal amount, interest rate and Fixed Rate Term applicable thereto and any payments made thereon on Bank's books and records (either manually or by electronic entry) and/or on any schedule attached to this Note, which notations shall be prima facie evidence of the accuracy of the information noted.

(b) Selection of Interest Rate Options. At any time any portion of this Note bears interest determined in relation to LIBOR, it may be continued by Borrower at the end of the Fixed Rate Term applicable thereto so that all or a portion thereof bears interest determined in relation to the Prime Rate or to LIBOR for a new Fixed Rate Term designated by Borrower. At any time any portion of this Note bears interest determined in relation to the Prime Rate, Borrower may convert all or a portion thereof so that it bears interest determined in relation to LIBOR for a Fixed Rate Term designated by Borrower. At such time as Borrower requests an advance hereunder or wishes to select a LIBOR option for all or a portion of the outstanding principal balance hereof, and at the end of each Fixed Rate Term, Borrower shall give Bank notice specifying: (i) the interest rate option selected by Borrower; (ii) the principal amount subject thereto; and (iii) for each LIBOR selection, the length of the applicable Fixed Rate Term. Any such notice may be given by telephone (or such other electronic method as Bank may permit) so long as, with respect to each LIBOR selection, (A) if requested by Bank, Borrower provides to Bank written confirmation thereof not later than three (3) Business Days after such notice is given, and (B) such notice is given to Bank prior to 10:00 a.m. on the first day of the Fixed Rate Term, or at a later time during any Business Day if Bank, at its sole option but without obligation to do so, accepts Borrower's notice and quotes a fixed rate to Borrower. If Borrower does not immediately accept a fixed rate when quoted by Bank, the quoted rate shall expire and any subsequent LIBOR request from Borrower shall be subject to a redetermination by Bank of the applicable fixed rate. If no specific designation of interest is made at the time any advance is requested hereunder or at the end of any Fixed Rate Term, Borrower shall be deemed to have made a Prime Rate interest selection for such advance or the principal amount to which such Fixed Rate Term applied.

(c) Taxes and Regulatory Costs. Borrower shall pay to Bank immediately upon demand, in addition to any other amounts due or to become due hereunder, any and all (i) withholdings, interest equalization taxes, stamp taxes or other taxes (except income and franchise taxes) imposed by any domestic or foreign governmental authority and related in any manner to LIBOR, and (ii) future, supplemental, emergency or other changes in the LIBOR Reserve Percentage, assessment rates imposed by the Federal Deposit Insurance Corporation, or similar requirements or costs imposed by any domestic or foreign governmental authority or resulting from compliance by Bank with any request or directive (whether or not having the force of law) from any central bank or other governmental authority and related in any manner to LIBOR to the extent they are not included in the calculation of LIBOR. In determining which of the foregoing are attributable to any LIBOR option available to Borrower hereunder, any reasonable allocation made by Bank among its operations shall be conclusive and binding upon Borrower.

(d) Payment of Interest. Interest accrued on this Note shall be payable on the 1st day of each month, commencing March 1, 2011.

(e) Default Interest. From and after the maturity date of this Note, or such earlier date as all principal owing hereunder becomes due and payable by acceleration or otherwise, or at Bank's option upon the occurrence, and during the continuance of an Event of Default, the outstanding principal balance of this Note shall bear interest at an increased rate per annum (computed on the basis of a 360-day year, actual days elapsed) equal to four percent (4%) above the rate of interest from time to time applicable to this Note.

BORROWING AND REPAYMENT:

(a) Borrowing and Repayment. Borrower may from time to time during the term of this Note borrow, partially or wholly repay its outstanding borrowings, and reborrow, subject to all of the limitations, terms and conditions of this Note and of any document executed in connection with or governing this Note; provided however, that the total outstanding borrowings under this Note shall not at any time exceed the principal amount stated above. The unpaid principal balance of this obligation at any time shall be the total amounts advanced hereunder by the holder hereof less the amount of principal payments made hereon by or for Borrower, which balance may be endorsed hereon from time to time by the holder. The outstanding principal balance of this Note shall be due and payable in full on February 1, 2013.

(b) Advances. Advances hereunder, to the total amount of the principal sum stated above, may be made by the holder at the oral or written request of (i) Balu Balakrishnan or Eric Verity, or Sandeep Nayyar, any one acting alone, who are authorized to request advances and direct the disposition of any advances until written notice of the revocation of such authority is received by the holder at the office designated above, or (ii) any person, with respect to advances deposited to the credit of any deposit account of Borrower, which advances, when so deposited, shall be conclusively presumed to have been made to or for the benefit of Borrower regardless of the fact that persons other than those authorized to request advances may have authority to draw against such account. The holder shall have no obligation to determine whether any person requesting an advance is or has been authorized by Borrower.

(c) Application of Payments. Each payment made on this Note shall be credited first, to any interest then due and second, to the outstanding principal balance hereof. All payments credited to principal shall be applied first, to the outstanding principal balance of this Note which bears interest determined in relation to the Prime Rate, if any, and second, to the outstanding principal balance of this Note which bears interest determined in relation to LIBOR, with such payments applied to the oldest Fixed Rate Term first.

PREPAYMENT:

(a) Prime Rate. Borrower may prepay principal on any portion of this Note which bears interest determined in relation to the Prime Rate at any time, in any amount and without penalty.

(b) LIBOR . Borrower may prepay principal on any portion of this Note which bears interest determined in relation to LIBOR at any time and in the minimum amount of One Hundred Thousand Dollars ($100,000.00); provided however, that if the outstanding principal balance of such portion of this Note is less than said amount, the minimum prepayment amount shall be the entire outstanding principal balance thereof. In consideration of Bank providing this prepayment option to Borrower, or if any such portion of this Note shall become due and payable at any time prior to the last day of the Fixed Rate Term applicable thereto by acceleration or otherwise, Borrower shall pay to Bank immediately upon demand a fee which is the sum of the discounted monthly differences for each month from the month of prepayment through the month in which such Fixed Rate Term matures, calculated as follows for each such month:

(i) Determine the amount of interest which would have accrued each month on the amount prepaid at the interest rate applicable to such amount had it remained outstanding until the last day of the Fixed Rate Term applicable thereto.

(ii) Subtract from the amount determined in (i) above the amount of interest which would have accrued for the same month on the amount prepaid for the remaining term of such Fixed Rate Term at LIBOR in effect on the date of prepayment for new loans made for such term and in a principal amount equal to the amount prepaid.

(iii) If the result obtained in (ii) for any month is greater than zero, discount that difference by LIBOR used in (ii) above.

Borrower acknowledges that prepayment of such amount may result in Bank incurring additional costs, expenses and/or liabilities, and that it is difficult to ascertain the full extent of such costs, expenses and/or liabilities. Borrower, therefore, agrees to pay the above-described prepayment fee and agrees that said amount represents a reasonable estimate of the prepayment costs, expenses and/or liabilities of Bank. If Borrower fails to pay any prepayment fee when due, the amount of such prepayment fee shall thereafter bear interest until paid at a rate per annum two percent (2.00%) above the Prime Rate in effect from time to time (computed on the basis of a 360-day year, actual days elapsed). Please refer to the LIBOR early termination prepayment example attached hereto as Exhibit A for illustrative purposes only.

EVENTS OF DEFAULT:

This Note is made pursuant to and is subject to the terms and conditions of that certain Credit Agreement between Borrower and Bank dated as of February 22, 2011, as amended from time to time (the "Credit Agreement"). Any default in the payment or performance of any obligation under this Note, or any defined event of default under the Credit Agreement, shall constitute an "Event of Default" under this Note.

MISCELLANEOUS:

(a) Remedies . Upon the occurrence of any Event of Default, the holder of this Note, at the holder's option, may declare all sums of principal and interest outstanding hereunder to be immediately due and payable without presentment, demand, notice of nonperformance, notice of protest, protest or notice of dishonor, all of which are expressly waived by Borrower, and the obligation, if any, of the holder to extend any further credit hereunder shall immediately cease and terminate. Borrower shall pay to the holder immediately upon demand the full amount of all payments, advances, charges, costs and expenses, including reasonable attorneys' fees (to include outside counsel fees and all allocated costs of the holder's in-house counsel), expended or incurred by the holder in connection with the enforcement of the holder's rights and/or the collection of any amounts which become due to the holder under this Note, and the prosecution or defense of any action in any way related to this Note, including without limitation, any action for declaratory relief, whether incurred at the trial or appellate level, in an arbitration proceeding or otherwise, and including any of the foregoing incurred in connection with any bankruptcy proceeding (including without limitation, any adversary proceeding, contested matter or motion brought by Bank or any other person) relating to Borrower or any other person or entity.

(b) Obligations Joint and Several . Should more than one person or entity sign this Note as a Borrower, the obligations of each such Borrower shall be joint and several.

(c) Governing Law . This Note shall be governed by and construed in accordance with the laws of the State of California.

IN WITNESS WHEREOF, the undersigned has executed this Note as of the date first written above.

POWER INTEGRATIONS, INC.

By: /s/ Balu Balakrishnan
Balu Balakrishnan,
President & CEO

Exhibit A to Revolving Line of Credit Note

LIBOR EARLY TERMINATION PREPAYMENT EXAMPLE

Loan Amount advance under LIBOR rate	$1,000,000	
Initial Date	2/1/2011	
Initial Term	90-days	to 5/1/2011
Initial Rate (hypothetical rate for illustrative purposes only)	0.45%	
Termination Date	4/1/2011	4/1/2011
Days Remaining	30-days	30-days
LIBOR at date of Termination for Days Remaining (30-day LIBOR)	0.3%	0.5%

Two examples - one rate higher and one lower at time of termination.

90-day LIBOR at initial term compared to Remaining days, 30-day LIBOR rate at Termination Date

Prepayment Calculation

	Rate Lower	Rate Higher
Interest over Remaining 30-Days if no termination (0.45%, 30days remaining)	375	375
Interest over Remaining 30-Days at new LIBOR Rate at Termination date: (example 0.30% and 0.50% with 30-days remaining)	250	417
Difference in Interest over Remaining Days in term	125	(42)
Prepayment that would apply:	125	none

Exhibit 10.4

FIRST AMENDMENT TO CREDIT AGREEMENT

THIS AMENDMENT TO CREDIT AGREEMENT (this "Amendment") is entered into as of August 2, 2011, by and between POWER INTEGRATIONS, INC., a Delaware corporation ("Borrower"), and WELLS FARGO BANK, NATIONAL ASSOCIATION ("Bank").

RECITALS

WHEREAS, Borrower is currently indebted to Bank pursuant to the terms and conditions of that certain Credit Agreement between Borrower and Bank dated as of February 22, 2011, as amended from time to time ("Credit Agreement").

WHEREAS, Bank and Borrower have agreed to certain changes in the terms and conditions set forth in the Credit Agreement and have agreed to amend the Credit Agreement to reflect said changes.

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree that the Credit Agreement shall be amended as follows:

1. Section 1.1(b) is hereby deleted in its entirety, and the following substituted therefor:

"(b) Letter of Credit Subfeature . As a subfeature under the Line of Credit, Bank agrees from time to time during the term thereof to issue or cause an affiliate to issue commercial and standby letters of credit for the account of Borrower to back performance (each, a "Letter of Credit" and collectively, "Letters of Credit"); provided however, that the aggregate undrawn amount of all outstanding Letters of Credit shall not at any time exceed Twenty Million Dollars ($20,000,000.00). Unless cash secured to Bank's satisfaction, no Letter of Credit shall have an expiration date subsequent to the maturity date of the Line of Credit. The undrawn amount of all Letters of Credit shall be reserved under the Line of Credit and shall not be available for borrowings thereunder. Each Letter of Credit shall be subject to the additional terms and conditions of the Letter of Credit agreements, applications and any related documents required by Bank in connection with the issuance thereof. Each drawing paid under a Letter of Credit shall be deemed an advance under the Line of Credit and shall be repaid by Borrower in accordance with the terms and conditions of this Agreement applicable to such advances; provided however, that if advances under the Line of Credit are not available, for any reason, at the time any drawing is paid, then Borrower shall immediately pay to Bank the full amount drawn, together with interest thereon from the date such drawing is paid to the date such amount is fully repaid by Borrower, at the rate of interest applicable to advances under the Line of Credit. In such event Borrower agrees that Bank, in its sole discretion, may debit any account maintained by Borrower with Bank for the amount of any such drawing."

2. Section 1.2 (c) is hereby deleted in its entirety, and the following substituted therefor:

"(c) Standby and Commercial Letter of Credit Fees . Borrower shall pay to Bank (i) fees upon the issuance of each Standby and Commercial Letter of Credit equal to one and one quarter percent (1.25%) per annum (computed on the basis of a 360-day year, actual days elapsed) of the face amount thereof, and (ii) fees upon the payment or negotiation of each
drawing under any Standby and Commercial Letter of Credit and fees upon the occurrence of any other activity with respect to any Standby and Commercial Letter of Credit (including without limitation, the transfer, amendment or cancellation of any Standby and Commercial Letter of Credit) determined in accordance with Bank's standard fees and charges then in effect for such activity."

3. Except as specifically provided herein, all terms and conditions of the Credit Agreement remain

in full force and effect, without waiver or modification. All terms defined in the Credit Agreement shall have the same meaning when used in this Amendment. This Amendment and the Credit Agreement shall be read together, as one document.

4. Borrower hereby remakes all representations and warranties contained in the Credit Agreement and reaffirms all covenants set forth therein. Borrower further certifies that as of the date of this Amendment there exists no Event of Default as defined in the Credit Agreement, nor any condition, act or event which with the giving of notice or the passage of time or both would constitute any such Event of Default.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed as of the day and year first written above.

POWER INTEGRATIONS, INC.	WELLS FARGO BANK, NATIONAL ASSOCIATION
By: /s/ Balu Balakrishnan	By: /s/ Greg P. Cohn
Balu Balakrishnan, President & CEO	Greg P. Cohn, Vice President

Exhibit 10.5

SECOND AMENDMENT TO CREDIT AGREEMENT

THIS SECOND AMENDMENT TO CREDIT AGREEMENT (this "Amendment") is entered into as of April 2, 2012, by and between POWER INTEGRATIONS, INC., a Delaware corporation ("Borrower"), and WELLS FARGO BANK, NATIONAL ASSOCIATION ("Bank").

RECITALS

WHEREAS, Borrower is currently indebted to Bank pursuant to the terms and conditions of that certain Credit Agreement between Borrower and Bank dated as of February 22, 2011, as amended from time to time ("Credit Agreement").

WHEREAS, Bank and Borrower have agreed to certain changes in the terms and conditions set forth in the Credit Agreement and have agreed to amend the Credit Agreement to reflect said changes.

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree that the Credit Agreement shall be amended as follows:

1. Section 1.1(a) is hereby amended by deleting "Fifty Million Dollars ($50,000,000.00)" as the maximum principal amount available under the Revolving Line of Credit Note, and by substituting for said amount "Sixty-Five Million Dollars ($65,000,000.00)," with such change to be effective upon the execution and delivery to Bank of a promissory note dated as of April 2, 2012 (which promissory note shall replace and be deemed the Revolving Line of Credit Note defined in and made pursuant to the Credit Agreement) and all other contracts, instruments and documents required by Bank to evidence such change.

2. Section 4.9(a) is hereby amended by deleting “1.50 to 1.00” as the Modified Quick Ratio and substituting “1.05 to 1.00” in its place.

3. Section 4.9(b) is hereby deleted in its entirety, and the following substituted therefor:

> (b) Funded Debt to EBITDA not greater than 2.0 to 1.0 at all times, measured quarterly using trailing 12 months EBITDA. For the purposes of this Section 4.9(b), “ Funded Debt ” shall be defined as consolidated indebtedness of the Borrower and its Subsidiaries (including any current portions thereof) determined on a consolidated basis in accordance with GAAP, without duplication, including, without limitation, the outstanding and all obligations evidenced by notes, loan agreements or other similar instruments, bonds, debentures, reimbursement agreements, bankers' acceptances, bank guaranties, surety bonds and similar instruments, and “ EBIDTA ” shall be defined for any period as the sum of the following for such period determined on a consolidated basis, without duplication, for the Borrower and its Subsidiaries in accordance with GAAP: (i) consolidated net income during such period, minus (ii) to the extent included in the calculation of consolidated net income, (A) extraordinary or other non-recurring non-cash losses, including any non-cash charges for stock-based compensation expenses and impairment of intangibles, (B) consolidated interest expense, (C) income taxes, (D) amortization and depreciation, (E) write-up of acquired inventory to fair market value in

accordance with GAAP, and (F) expense incurred in connection with certain one-time events as may in the future occur, subject to the mutual agreement of Borrower and Bank.

4. Except as specifically provided herein, all terms and conditions of the Credit Agreement remain in full force and effect, without waiver or modification. All terms defined in the Credit Agreement shall have the same meaning when used in this Amendment. This Amendment and the Credit Agreement shall be read together, as one document.

5. Borrower hereby remakes all representations and warranties contained in the Credit Agreement and reaffirms all covenants set forth therein. Borrower further certifies that as of the date of this Amendment there exists no Event of Default as defined in the Credit Agreement, nor any condition, act or event which with the giving of notice or the passage of time or both would constitute any such Event of Default.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed as of the day and year first written above.

POWER INTEGRATIONS, INC.	WELLS FARGO BANK, NATIONAL ASSOCIATION
By: /s/ Balu Balakrishnan	By: /s/ Greg P. Cohn
Balu Balakrishnan, President and CEO	Greg P. Cohn, SVP / Relationship Manager

REVOLVING LINE OF CREDIT NOTE

$65,000,000.00 San Jose, California
April 2, 2012

FOR VALUE RECEIVED, the undersigned POWER INTEGRATIONS, INC. ("Borrower") promises to pay to the order of WELLS FARGO BANK, NATIONAL ASSOCIATION ("Bank") at its office at 121 S. Market Street, 2 nd Floor, San Jose, California 95113, or at such other place as the holder hereof may designate, in lawful money of the United States of America and in immediately available funds, the principal sum of Sixty-Five Million Dollars ($65,000,000.00), or so much thereof as may be advanced and be outstanding, with interest thereon, to be computed on each advance from the date of its disbursement as set forth herein.

DEFINITIONS:

As used herein, the following terms shall have the meanings set forth after each, and any other term defined in this Note shall have the meaning set forth at the place defined:

(a) "Business Day" means any day except a Saturday, Sunday or any other day on which commercial banks in California are authorized or required by law to close.

(b) "Fixed Rate Term" means a period commencing on a Business Day and continuing for one (1), three (3), or six (6) months, as designated by Borrower, during which all or a portion of the outstanding principal balance of this Note bears interest determined in relation to LIBOR; provided however, that no Fixed Rate Term may be selected for a principal amount less than One Hundred Thousand Dollars ($100,000.00); and provided further, that no Fixed Rate Term shall extend beyond the scheduled maturity date hereof. If any Fixed Rate Term would end on a day which is not a Business Day, then such Fixed Rate Term shall be extended to the next succeeding Business Day.

(c) "LIBOR" means the rate per annum (rounded upward, if necessary, to the nearest whole 1/8 of 1%) and determined pursuant to the following formula:

$$\text{LIBOR} = \frac{\text{Base LIBOR}}{100\% - \text{LIBOR Reserve Percentage}}$$

(i) "Base LIBOR" means the rate per annum for United States dollar deposits quoted by Bank as the Inter-Bank Market Offered Rate, with the understanding that such rate is quoted by Bank for the purpose of calculating effective rates of interest for loans making reference thereto, on the first day of a Fixed Rate Term for delivery of funds on said date for a period of time approximately equal to the number of days in such Fixed Rate Term and in an amount approximately equal to the principal amount to which such Fixed Rate Term applies. Borrower understands and agrees that Bank may base its quotation of the Inter-Bank Market Offered Rate upon such offers or other market indicators of the Inter-Bank Market as Bank in its discretion deems appropriate including, but not limited to, the rate offered for U.S. dollar deposits on the London Inter-Bank Market.

(ii) "LIBOR Reserve Percentage" means the reserve percentage prescribed by the Board of Governors of the Federal Reserve System (or any successor) for "Eurocurrency Liabilities" (as defined in Regulation D of the Federal Reserve Board, as amended), adjusted by Bank for expected changes in such reserve percentage during the applicable Fixed Rate Term.

(d) "Prime Rate" means at any time the rate of interest most recently announced within Bank at its principal office as its Prime Rate, with the understanding that the Prime Rate is one of Bank's base rates and serves as the basis upon which effective rates of interest are calculated for those loans making reference thereto, and is evidenced by the recording thereof after its announcement in such internal publication or publications as Bank may designate.

INTEREST:

(a) Interest . The outstanding principal balance of this Note shall bear interest (computed on the basis of a 360-day year, actual days elapsed) either, as designated by Borrower at Borrower's option, (i) at a fluctuating rate per annum equal to the Prime Rate in effect from time to time, or (ii) at a fixed rate per annum determined by Bank to be one and one-half percent (1.50%) above LIBOR in effect on the first day of the applicable Fixed Rate Term. When interest is determined in relation to the Prime Rate, each change in the rate of interest hereunder shall become effective on the date each Prime Rate change is announced within Bank. With respect to each LIBOR selection hereunder, Bank is hereby authorized to note the date, principal amount, interest rate and Fixed Rate Term applicable thereto and any payments made thereon on Bank's books and records (either manually or by electronic entry) and/or on any schedule attached to this Note, which notations shall be prima facie evidence of the accuracy of the information noted.

(b) Selection of Interest Rate Options . At any time any portion of this Note bears interest determined in relation to LIBOR, it may be continued by Borrower at the end of the Fixed Rate Term applicable thereto so that all or a portion thereof bears interest determined in relation to the Prime Rate or to LIBOR for a new Fixed Rate Term designated by Borrower. At any time any portion of this Note bears interest determined in relation to the Prime Rate, Borrower may convert all or a portion thereof so that it bears interest determined in relation to LIBOR for a Fixed Rate Term designated by Borrower. At such time as Borrower requests an advance hereunder or wishes to select a LIBOR option for all or a portion of the outstanding principal balance hereof, and at the end of each Fixed Rate Term, Borrower shall give Bank notice specifying: (i) the interest rate option selected by Borrower; (ii) the principal amount subject thereto; and (iii) for each LIBOR selection, the length of the applicable Fixed Rate Term. Any such notice may be given by telephone (or such other electronic method as Bank may permit) so long as, with respect to each LIBOR selection, (A) if requested by Bank, Borrower provides to Bank written confirmation thereof not later than three (3) Business Days after such notice is given, and (B) such notice is given to Bank prior to 10:00 a.m. on the first day of the Fixed Rate Term, or at a later time during any Business Day if Bank, at its sole option but without obligation to do so, accepts Borrower's notice and quotes a fixed rate to Borrower. If Borrower does not immediately accept a fixed rate when quoted by Bank, the quoted rate shall expire and any subsequent LIBOR request from Borrower shall be subject to a redetermination by Bank of the applicable fixed rate. If no specific designation of interest is made at the time any advance is requested hereunder or at the end of any Fixed Rate Term, Borrower shall be deemed to have made a Prime Rate interest selection for such advance or the principal amount to which such Fixed Rate Term applied.

(c) Taxes and Regulatory Costs . Borrower shall pay to Bank immediately upon demand, in addition to any other amounts due or to become due hereunder, any and all (i) withholdings, interest equalization taxes, stamp taxes or other taxes (except income and franchise taxes) imposed by any domestic or foreign governmental authority and related in any manner to LIBOR, and (ii) future, supplemental, emergency or other changes in the LIBOR Reserve Percentage, assessment rates imposed by the Federal Deposit Insurance Corporation, or similar requirements or costs imposed by any domestic or foreign governmental authority or resulting from compliance by Bank with any request or directive (whether or not having the force of law) from any central bank or other governmental authority and related in any manner to LIBOR to the extent they are not included in the calculation of LIBOR. In determining which of the foregoing are attributable to any LIBOR option available to Borrower hereunder, any reasonable allocation made by Bank among its operations shall be conclusive and binding upon Borrower.

(d) Payment of Interest. Interest accrued on this Note shall be payable on the 1st day of each month, commencing May 1, 2012.

(e) Default Interest. From and after the maturity date of this Note, or such earlier date as all principal owing hereunder becomes due and payable by acceleration or otherwise, or at Bank's option upon the occurrence, and during the continuance of an Event of Default, the outstanding principal balance of this Note shall bear interest at an increased rate per annum (computed on the basis of a 360-day year, actual days elapsed) equal to four percent (4%) above the rate of interest from time to time applicable to this Note.

BORROWING AND REPAYMENT:

(a) Borrowing and Repayment. Borrower may from time to time during the term of this Note borrow, partially or wholly repay its outstanding borrowings, and reborrow, subject to all of the limitations, terms and conditions of this Note and of any document executed in connection with or governing this Note; provided however, that the total outstanding borrowings under this Note shall not at any time exceed the principal amount stated above. The unpaid principal balance of this obligation at any time shall be the total amounts advanced hereunder by the holder hereof less the amount of principal payments made hereon by or for Borrower, which balance may be endorsed hereon from time to time by the holder. The outstanding principal balance of this Note shall be due and payable in full on February 1, 2013.

(b) Advances. Advances hereunder, to the total amount of the principal sum stated above, may be made by the holder at the oral or written request of (i) Balu Balakrishnan or Eric Verity, or Sandeep Nayyar, any one acting alone, who are authorized to request advances and direct the disposition of any advances until written notice of the revocation of such authority is received by the holder at the office designated above, or (ii) any person, with respect to advances deposited to the credit of any deposit account of Borrower, which advances, when so deposited, shall be conclusively presumed to have been made to or for the benefit of Borrower regardless of the fact that persons other than those authorized to request advances may have authority to draw against such account. The holder shall have no obligation to determine whether any person requesting an advance is or has been authorized by Borrower.

(c) Application of Payments. Each payment made on this Note shall be credited first, to any interest then due and second, to the outstanding principal balance hereof. All payments credited to principal shall be applied first, to the outstanding principal balance of this Note which bears interest determined in relation to the Prime Rate, if any, and second, to the outstanding principal balance of this Note which bears interest determined in relation to LIBOR, with such payments applied to the oldest Fixed Rate Term first.

PREPAYMENT:

(a) Prime Rate. Borrower may prepay principal on any portion of this Note which bears interest determined in relation to the Prime Rate at any time, in any amount and without penalty.

(b) LIBOR. Borrower may prepay principal on any portion of this Note which bears interest determined in relation to LIBOR at any time and in the minimum amount of One Hundred Thousand Dollars ($100,000.00); provided however, that if the outstanding principal balance of such portion of this Note is less than said amount, the minimum prepayment amount shall be the entire outstanding principal balance thereof. In consideration of Bank providing this prepayment option to Borrower, or if any such portion of this Note shall become due and payable at any time prior to the last day of the Fixed Rate Term applicable thereto by acceleration or otherwise, Borrower shall pay to Bank immediately upon demand a fee which is the sum of the discounted monthly differences for each month from the month of prepayment through the month in which such Fixed Rate Term matures, calculated as follows for each such month:

(i) Determine the amount of interest which would have accrued each month on the amount prepaid at the interest rate applicable to such amount had it remained outstanding until the last day of the Fixed Rate Term applicable thereto.

(ii) Subtract from the amount determined in (i) above the amount of interest which would have accrued for the same month on the amount prepaid for the remaining term of such Fixed Rate Term at LIBOR in effect on the date of prepayment for new loans made for such term and in a principal amount equal to the amount prepaid.

(iii) If the result obtained in (ii) for any month is greater than zero, discount that difference by LIBOR used in (ii) above.

Borrower acknowledges that prepayment of such amount may result in Bank incurring additional costs, expenses and/or liabilities, and that it is difficult to ascertain the full extent of such costs, expenses and/or liabilities. Borrower, therefore, agrees to pay the above-described prepayment fee and agrees that said amount represents a reasonable estimate of the prepayment costs, expenses and/or liabilities of Bank. If Borrower fails to pay any prepayment fee when due, the amount of such prepayment fee shall thereafter bear interest until paid at a rate per annum two percent (2.00%) above the Prime Rate in effect from time to time (computed on the basis of a 360-day year, actual days elapsed). Please refer to the LIBOR early termination prepayment example attached hereto as Exhibit A for illustrative purposes only.

EVENTS OF DEFAULT:

This Note is made pursuant to and is subject to the terms and conditions of that certain Credit Agreement between Borrower and Bank dated as of February 22, 2011, as amended from time to time (the "Credit Agreement"). Any default in the payment or performance of any obligation under this Note, or any defined event of default under the Credit Agreement, shall constitute an "Event of Default" under this Note.

MISCELLANEOUS:

(a) Remedies . Upon the occurrence of any Event of Default, the holder of this Note, at the holder's option, may declare all sums of principal and interest outstanding hereunder to be immediately due and payable without presentment, demand, notice of nonperformance, notice of protest, protest or notice of dishonor, all of which are expressly waived by Borrower, and the obligation, if any, of the holder to extend any further credit hereunder shall immediately cease and terminate. Borrower shall pay to the holder immediately upon demand the full amount of all payments, advances, charges, costs and expenses, including reasonable attorneys' fees (to include outside counsel fees and all allocated costs of the holder's in-house counsel), expended or incurred by the holder in connection with the enforcement of the holder's rights and/or the collection of any amounts which become due to the holder under this Note, and the prosecution or defense of any action in any way related to this Note, including without limitation, any action for declaratory relief, whether incurred at the trial or appellate level, in an arbitration proceeding or otherwise, and including any of the foregoing incurred in connection with any bankruptcy proceeding (including without limitation, any adversary proceeding, contested matter or motion brought by Bank or any other person) relating to Borrower or any other person or entity.

(b) Obligations Joint and Several. Should more than one person or entity sign this Note as a Borrower, the obligations of each such Borrower shall be joint and several.

(c) Governing Law. This Note shall be governed by and construed in accordance with the laws of the State of California.

IN WITNESS WHEREOF, the undersigned has executed this Note as of the date first written above.

POWER INTEGRATIONS, INC.

By: /s/ Balu Balakrishnan
Balu Balakrishnan,
President & CEO

Exhibit A to Revolving Line of Credit Note

LIBOR EARLY TERMINATION PREPAYMENT EXAMPLE

Loan Amount advance under LIBOR rate	$1,000,000	
Initial Date	2/1/2011	
Initial Term	90-days	to 5/1/2011
Initial Rate (hypothetical rate for illustrative purposes only)	0.45%	
Termination Date	4/1/2011	4/1/2011
Days Remaining	30-days	30-days
LIBOR at date of Termination for Days Remaining (30-day LIBOR)	0.30%	0.50%

Two examples - one rate higher and one lower at time of termination.

90-day LIBOR at initial term compared to Remaining days, 30-day LIBOR rate at Termination Date

Prepayment Calculation

	Rate Lower	Rate Higher
Interest over Remaining 30-Days if no termination (0.45%, 30days remaining)	375	375
Interest over Remaining 30-Days at new LIBOR Rate at Termination date: (example 0.30% and 0.50% with 30-days remaining)	250	417
Difference in Interest over Remaining Days in term	125	(42)
Prepayment that would apply:	125	none

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Balu Balakrishnan certify that:

1. I have reviewed this Form 10-Q of Power Integrations, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

    (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 7, 2012

By: /s/ BALU BALAKRISHNAN
Balu Balakrishnan
Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Sandeep Nayyar, certify that:

1. I have reviewed this Form 10-Q of Power Integrations, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 7, 2012

By: /s/ SANDEEP NAYYAR

Sandeep Nayyar
Chief Financial Officer

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Power Integrations, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2012 , as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Balu Balakrishnan, Chief Executive Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ("Section 906"), certify to the best of my knowledge that:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated:	May 7, 2012	By:	/s/ BALU BALAKRISHNAN
			Balu Balakrishnan Chief Executive Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Power Integrations, Inc. (the “Company”) on Form 10-Q for the quarter ended March 31, 2012 , as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Sandeep Nayyar, Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (“Section 906”), certify to the best of my knowledge that:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated:	May 7, 2012	By:	/s/ SANDEEP NAYYAR
			Sandeep Nayyar Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.