

MEMSIC Inc  
Form 10-Q  
May 14, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2010

or

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

For the transition period from            to

Commission File No. 001-33813

**MEMSIC, Inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)  
**One Tech Drive, Suite 325**  
**Andover, Massachusetts**  
(Address of principal executive offices)

**04-3457049**  
(I.R.S. Employer  
Identification No.)  
**01810**  
(Zip Code)  
**(978) 738-0900**  
(Registrant's telephone number, including area code)

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

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

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

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

The number of shares of common stock, par value \$0.00001 per share, of the registrant outstanding as of May 11, 2010 was 23,804,863.

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**MEMSIC, Inc.**

**FORM 10-Q, March 31, 2010**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****MEMSIC, Inc.****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

|   | March 31,<br>2010 | December 31,<br>2009 |
|---|-------------------|----------------------|
| <b>ASSETS</b>   |                   |                      |
| Current assets:   |                   |                      |
| Cash and cash equivalents   | \$ 47,763,764     | \$ 66,970,736        |
| Restricted cash   | 863,452           | 863,439              |
| Accounts receivable, net of allowance for doubtful accounts of \$6,441 as of March 31, 2010 and December 31, 2009, respectively   | 3,087,411         | 2,670,144            |
| Inventories   | 4,777,654         | 4,988,611            |
| Other assets  | 1,955,367         | 1,004,458            |
| Total current assets  | 58,447,648        | 76,497,388           |
| Property and equipment, net   | 15,936,212        | 14,591,828           |
| Long-term investments   | 5,173,000         | 5,353,000            |
| Goodwill  | 4,752,417         |                      |
| Intangible assets, net  | 12,599,970        | 988,270              |
| Other assets  | 192,921           | 81,455               |
| Total assets  | \$ 97,102,168     | \$ 97,511,941        |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                   |                      |
| Current liabilities:  |                   |                      |
| Accounts payable  | \$ 2,246,411      | \$ 1,115,694         |
| Accrued expenses  | 1,696,293         | 1,662,518            |
| Advance research funding  | 863,452           | 863,439              |
| Total current liabilities   | 4,806,156         | 3,641,651            |
| Stockholders equity:  |                   |                      |
| Common stock, \$0.00001 par value; authorized, 45,000,000 shares; 23,804,863 and 23,793,113 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively | 238               | 238                  |
| Additional paid-in capital  | 98,509,032        | 98,112,408           |
| Accumulated other comprehensive income  | 2,223,082         | 2,218,496            |
| Accumulated deficit   | (8,780,814)       | (6,460,852)          |
| MEMSIC, Inc. stockholders equity  | 91,951,538        | 93,870,290           |
| Noncontrolling interest related to joint venture in Japan   | 344,474           |                      |
| Total equity  | 92,296,012        | 93,870,290           |
| Total liabilities and stockholders equity   | \$ 97,102,168     | \$ 97,511,941        |

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See accompanying notes to condensed consolidated financial statements (unaudited)

**Table of Contents****MEMSIC, Inc.****CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

|   | <b>Three Months Ended<br/>March 31,</b> |              |
|---|---|--------------|
|   | <b>2010</b>                             | <b>2009</b>  |
| Net sales   | \$ 7,271,993                            | \$ 6,574,666 |
| Cost of goods sold  | 4,426,499                               | 3,441,642    |
| Gross profit  | 2,845,494                               | 3,133,024    |
| Operating expenses:   |   |              |
| Research and development  | 1,973,657                               | 1,170,165    |
| Sales and marketing   | 1,071,479                               | 576,779      |
| General and administrative  | 2,323,808                               | 1,422,697    |
| Total operating expenses  | 5,368,944                               | 3,169,641    |
| Operating loss  | (2,523,450)                             | (36,617)     |
| Other income:   |   |              |
| Interest and dividend income  | 116,664                                 | 257,865      |
| Other, net  | 17,530                                  | 3,461        |
| Total other income  | 134,194                                 | 261,326      |
| Earnings (loss) before income taxes   | (2,389,256)                             | 224,709      |
| Provision (benefit) for income taxes  | (116,435)                               | 167,538      |
| Net income (loss)   | (2,272,821)                             | 57,171       |
| Less: net income attributable to noncontrolling interest                                    | 47,141                                  |              |
| Net income (loss) attributable to MEMSIC, Inc.  | \$ (2,319,962)                          | \$ 57,171    |
| Net income (loss) per common share:   |   |              |
| Basic   | \$ (0.10)                               | \$ 0.00      |
| Diluted   | \$ (0.10)                               | \$ 0.00      |
| Weighted average shares outstanding used in calculating net income (loss) per common share: |   |              |
| Basic   | 23,797,008                              | 23,698,639   |
| Diluted   | 23,797,008                              | 23,842,524   |

See accompanying notes to condensed consolidated financial statements (unaudited)



**Table of Contents****MEMSIC, Inc.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

|   | <b>Three Months Ended<br/>March 31,</b> |                      |
|---|---|----------------------|
|   | <b>2010</b>                             | <b>2009</b>          |
| <b>Cash flows from operating activities:</b>  |   |                      |
| Net income (loss)   | \$ (2,272,821)                          | \$ 57,171            |
| <b>Adjustments to reconcile net income (loss) to cash used in operating activities:</b> |   |                      |
| Depreciation and amortization   | 879,231                                 | 517,483              |
| Stock compensation expense  | 383,489                                 | 336,693              |
| Deferred income taxes   | (182,100)                               | (13,071)             |
| <b>Changes in assets and liabilities, net of effect of acquired business:</b>           |   |                      |
| Accounts receivable   | (215,218)                               | (1,552,764)          |
| Inventories   | 823,112                                 | 708,857              |
| Other assets  | (703,418)                               | (549,633)            |
| Accounts payable and accrued expenses   | 875,132                                 | (58,303)             |
| <b>Net cash used in operating activities</b>  | <b>(412,593)</b>                        | <b>(553,567)</b>     |
| <b>Cash flows provided by (used in) investing activities:</b>                           |   |                      |
| Proceeds from sale of investments   | 180,000                                 | 1,682,065            |
| Purchase of property and equipment  | (1,290,531)                             | (837,065)            |
| Acquisition payment net of acquired cash of \$352,247                                   | (17,647,753)                            |                      |
| <b>Net cash provided by (used in) investing activities</b>                              | <b>(18,758,284)</b>                     | <b>845,000</b>       |
| <b>Cash flows provided by (used in) financing activities:</b>                           |   |                      |
| Cash dividend paid to non-controlling interest  | (56,838)                                |                      |
| Proceeds from exercise of options to purchase common stock                              | 13,135                                  | 1,500                |
| <b>Net cash provided by (used in) financing activities</b>                              | <b>(43,703)</b>                         | <b>1,500</b>         |
| Effect of exchange rate changes on cash and cash equivalents                            | 7,608                                   | (1,359)              |
| <b>Net increase (decrease) in cash and cash equivalents</b>                             | <b>(19,206,972)</b>                     | <b>291,574</b>       |
| Cash and cash equivalents beginning of period   | 66,970,736                              | 64,365,607           |
| <b>Cash and cash equivalents end of period</b>  | <b>\$ 47,763,764</b>                    | <b>\$ 64,657,181</b> |

See accompanying notes to condensed consolidated financial statements (unaudited)

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**MEMSIC, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**1. NATURE OF THE BUSINESS AND OPERATIONS**

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

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

**2. ACQUISITION**

On January 15, 2010, the Company completed the acquisition of assets related to Crossbow Technology, Inc.'s commercial (non-military) Inertial Systems business and Wireless Sensor Network Mote and eKo business (collectively, the Business), including intellectual property rights, fixed assets relating to the Business and 153 shares of Crossbow Japan Limited (Crossbow Japan), representing 51% ownership of the entity. The purchase price for the Business consisted of a payment of \$18 million in cash at the closing.

**Table of Contents****Purchase Price Allocation**

The allocation of the purchase price and the purchase price accounting is based on the fair value of the acquired assets and liabilities measured on January 15, 2010 in accordance with ASC topic 805, *Business Combinations*.

The purchase price paid for the acquisition is as follows:

|                      |               |
|----------------------|---------------|
| Cash paid            | \$ 18,000,000 |
| Total purchase price | \$ 18,000,000 |

The allocation of the purchase price is as follows:

|  |                 |
|--|-----------------|
| Working capital  | \$ 1,113,399(1) |
| Property and equipment   | 593,929         |
| Trademarks   | 396,730         |
| Customer relationships   | 4,495,003       |
| Developed technology   | 6,998,000       |
| Goodwill   | 4,752,417       |
|  | 18,349,478      |
| Non-controlling interest in majority owned Japan joint venture | (349,478)       |
| Allocation of purchase price                                   | \$ 18,000,000   |

Note (1): The working capital included the inventory at fair value of \$440,000 and \$125,000 in a current liability acquired from Crossbow Technology, Inc. and net current assets of \$799,000 acquired from Crossbow Japan. In the Company's Consolidated Cash Flow Statement, these amounts are included in investing activities and are excluded from the changes in assets and liabilities in operating activities.

**Pro Forma Revenue and Net Loss**

The Company's pro forma revenue, net loss and loss per share would have been \$7.7 million, \$2.5 million and (\$0.10) had the Company closed the acquisition on January 1, 2010 for the three months ended March 31, 2010. The pro forma revenue, net loss and loss per share would have been \$9.6 million, \$0.9 million and (\$0.04) had the Company closed the acquisition on January 1, 2009 for the three months ended March 31, 2009.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICES****Principles of Consolidation**

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

**Unaudited Interim Financial Information**

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The accompanying interim consolidated financial statements are unaudited. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and related notes, together with the management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, which is on file with the Securities and Exchange Commission (SEC).

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The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of management, the unaudited interim consolidated financial statements and notes have been prepared on the same basis as the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and include all adjustments (consisting of normal, recurring adjustments) necessary for the fair presentation of the Company's financial position at March 31, 2010, results of operations for the three months ended March 31, 2010 and 2009 and cash flows for the three months ended March 31, 2010 and 2009. The interim periods are not necessarily indicative of results to be expected for any other interim periods or for the full year.

### ***Use of Estimates***

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

### ***Cash Equivalents***

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

### ***Foreign Currency***

The Company's manufacturing operations and certain other operations are conducted by MEMSIC Semiconductor. The functional currency of MEMSIC Semiconductor is the Renminbi. Financial transactions between the Company and MEMSIC Semiconductor are conducted in United States (U.S.) dollars. At March 31, 2010 and December 31, 2009, the underlying currency for approximately 38.3% and 39.5% of consolidated assets, respectively, was the Renminbi. The functional currency of the acquired joint venture Crossbow Japan is the Japanese Yen. Financial transactions between the Company and Crossbow Japan are conducted in U.S. dollars. At March 31, 2010, the underlying currency for approximately 1.1% of consolidated assets was the Japanese Yen. The Company does not believe that it is subject to significant foreign exchange risk and, accordingly, has not utilized hedging strategies with respect to its foreign exchange exposure.

The financial statements of MEMSIC Semiconductor and Crossbow Japan are translated into U.S. dollars in accordance with U.S. GAAP. The functional currencies of MEMSIC Semiconductor and Crossbow Japan are translated into United States dollars utilizing the following method: assets and liabilities are translated at the exchange rate in effect at the end of the period, and revenues and expenses are translated at the weighted average exchange rate during the year. Cumulative translation gains and losses are included as a separate component of stockholders equity and reported as a part of comprehensive income. Transaction gains and losses are included in the consolidated statements of operations as incurred.

### ***Fair Value of Financial Instruments***

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

### ***Net Income (Loss) per Common Share***

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

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### ***Income Taxes***

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

### ***Inventories***

Inventories are stated at the lower of cost (weighted average FIFO) or market. The Company evaluates its inventory for potential excess and obsolete inventories based on forecasted demands and records a provision for such amounts as necessary. At March 31, 2010 and December 31, 2009, the Company's total inventory reserve balance was \$441,000 and \$549,000, respectively.

### ***Revenue Recognition***

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

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

### ***Stock-Based Compensation***

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

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***Recent Accounting Pronouncements***

The Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) became effective for the Company in the quarter ended September 30, 2009. The Codification brings together in one place all authoritative GAAP and substantially retains existing GAAP. This change did not affect the Company's consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements*. This Update requires new disclosures for transfers in and out of Level 1 and 2 and activity in Level 3. This Update also clarifies existing disclosures for level of disaggregation and about inputs and valuation techniques. The new disclosures are effective for interim and annual periods beginning after December 15, 2009, except for the Level 3 disclosures, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those years. The adoption of ASU 2010-06 did not have a material impact on the Company's financial position or results of operations.

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

In December 2007, the FASB issued ASC topic 805, *Business Combinations*. This statement is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. For the Company, this statement is effective prospectively for business combinations for which the acquisition date is on or after January 1, 2009. The adoption of the provisions of this statement did not have any impact on the Company's financial position and results of operations. The Company followed this provision for its accounting for the Crossbow acquisition.

In December 2007, general standards of accounting for disclosure of events that have occurred after the balance sheet date but before financial statements are issued were established. ASC topic 855, (originally issued as SFAS No. 165, *Subsequent Events*) provides the general standards which are applicable for interim or annual financial periods ending after June 15, 2009. Effective June 15, 2009, the Company adopted the provisions of ASC 855 and has evaluated subsequent events as required by this standard. See note 17.

**4. LONG-TERM INVESTMENTS**

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

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

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At March 31, 2010, the Company held two ARS investments: Illinois Educational Facilities Authority Select Auction Variable Rate Securities having a value at par of \$3.0 million with a maturity date in 2028 and Montana Health Facility Authority Select Auction Variable Rate Securities having a value at par of \$2.4 million with a maturity date in 2017. The Company has classified these investments as long-term assets due to liquidity issues that have recently been experienced in global credit and capital markets as well as failed auctions since the first quarter of 2008. A failed auction means that the amount of securities submitted for sale at auction exceeded the amount of purchase orders. If an auction fails, the issuer becomes obligated to pay interest at penalty rates, and all of the auction rate securities the Company holds continue to pay interest in accordance with their stated terms. However, the failed auctions create uncertainty as to the liquidity of these securities.

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

**Fair Value Measurement**

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

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

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

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

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

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

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

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

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

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

|                         | Carrying amount as of<br>March 31, 2010 | Level 1 | Level 2 | Level 3  | Valuation<br>Technique |
|-------------------------|---|---------|---------|----------|------------------------|
| Auction rate securities | \$ 5,173                                | \$      | \$      | \$ 5,173 | (B)                    |



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

|                                      | <b>Auction Rate Securities</b> |       |
|--------------------------------------|--------------------------------|-------|
| Balance at January 1, 2010           | \$                             | 5,353 |
| Redemptions                          |                                | (180) |
| Transfers to Level 3                 |                                |       |
| <i>Gains and losses:</i>             |                                |       |
| Reported in earnings                 |                                |       |
| Reported in other comprehensive loss |                                |       |
| Balance at March 31, 2010            | \$                             | 5,173 |

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

The Company's valuation analysis in the first quarter of 2010 resulted in no change in the unrealized impairment loss recorded at December 31, 2008. The Company continues to monitor the market for auction rate securities and to assess its impact on the fair value of the Company's investments. If current market conditions deteriorate further, the Company may be required to record additional temporary unrealized losses in other comprehensive income (loss) or, if the decline in fair value is judged to be other-than-temporary, the cost basis of the individual security may be written off to fair value as a new cost basis and the amount of the write-down would be reflected as a charge to earnings.

**5. INVENTORIES**

Inventories consist of the following:

|                 | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|-----------------|---------------------------|------------------------------|
| Raw materials   | \$ 2,174,953              | \$ 2,529,594                 |
| Work in process | 1,921,716                 | 1,715,212                    |
| Finished goods  | 680,985                   | 743,805                      |
| Total           | \$ 4,777,654              | \$ 4,988,611                 |

**Table of Contents****6. GOODWILL AND INTANGIBLE ASSETS****Goodwill**

Goodwill represents the excess cost of the Crossbow asset acquisition over the net fair value allocated to the assets acquired and liabilities assumed. The Company reported goodwill of \$4,752,417 at March 31, 2010.

The Company will perform an annual impairment test for goodwill during the fourth quarter of each fiscal year, and more frequently if an event or circumstances indicate that an impairment loss has been incurred. Conditions that would trigger an impairment assessment include, but are not limited to, a significant adverse change in legal factors or business climate that could affect the value of an asset.

**Intangible Assets**

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

Intangible assets consisted of the following:

|                          | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|--------------------------|---------------------------|------------------------------|
| Patents                  | \$ 844,041                | \$ 789,032                   |
| Know-how                 | 514,919                   | 509,200                      |
| Trademark                | 396,730                   |                              |
| Customer relations       | 4,495,003                 |                              |
| Developed technology     | 6,998,000                 |                              |
| Gross intangible assets  | 13,248,693                | 1,298,232                    |
| Accumulated amortization | (648,723)                 | (309,962)                    |
| Net intangible assets    | \$ 12,599,970             | \$ 988,270                   |

The Company amortizes its intangible assets based on the following expected life:

|                      | <b>Expected life<br/>(Years)</b> |
|----------------------|----------------------------------|
| Patents              | 15                               |
| Know-how             | 5                                |
| Trademark            | 2                                |
| Customer relations   | 8-10                             |
| Developed technology | 8-10                             |

Amortization expense expected over the next five years is approximately \$1.4 million per year. Amortization expense amounted to \$339,000 and \$37,000, respectively for the three months ended March 31, 2010 and 2009.

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

**Table of Contents****7. STOCK BASED COMPENSATION*****Description of Plan***

On March 29, 2000, the Company's stockholders and board of directors approved the 2000 Omnibus Stock Plan (the 2000 Plan), as amended, under which 2,969,000 shares of the Company's common stock were reserved for issuance to directors, officers, employees, and consultants. Options granted under the 2000 Plan may be incentive stock options, nonqualified stock options and/or restricted stock. The 2000 Plan provides that the exercise price of incentive stock options must be at least equal to the market value of the Company's common stock at the date such option is granted. For incentive stock option grants to an employee who owns more than 10% of the outstanding shares of common stock of the Company, the exercise price on the incentive stock option must be 110% of market value at the time of grant. Granted options expire in ten years or less from the date of grant and vest based on the terms of the awards, generally ratably over four years.

On August 22, 2007, the Company's board of directors approved the 2007 Stock Incentive Plan (the 2007 Plan), under which up to 3,000,000 shares of the Company's common stock may become available for issuance. At the adoption date, 1,526,425 shares were reserved for issuance. The reserved amount will increase by 300,000 shares at each of the five anniversaries of the adoption date, for a maximum of 3,000,000 shares issuable under the 2007 Plan. Prior to December 19, 2007, there was no public market for the Company's common stock. Accordingly, the board of directors determined the market value of the common stock at the date of grant by considering a number of relevant factors, including the Company's operating and financial performance and corporate milestones achieved, the prices at which shares of convertible preferred stock in arm's-length transactions were sold, the composition of and changes to the management team, the superior rights and preferences of securities senior to the common stock at the time of each grant and the likelihood of achieving a liquidity event for the shares of common stock underlying stock options.

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

***Valuation of Stock Options***

The Company uses the Black-Scholes option pricing model to calculate the grant-date fair value of an option award. The weighted-average fair values per share of the options granted during the three months ended March 31, 2010 and 2009 were \$2.14 and \$1.72, respectively, utilizing the following assumptions:

|                         | Three months ended |            |
|-------------------------|--------------------|------------|
|                         | March 31,          |            |
|                         | 2010               | 2009       |
| Volatility              | 69% -70%           | 77%        |
| Expected dividend yield | 0%                 | 0%         |
| Expected life           | 5.8 -6.0 years     | 5 years    |
| Risk free interest rate | 2.4%               | 1.6% -1.9% |
| Forfeitures             | 36% -37%           | 28% -46%   |

The Company is responsible for estimating volatility and has considered a number of factors, including analysis of volatility data for a peer group of companies. The Company determined the volatility for options granted in the three months ended March 31, 2010 based on the implied volatility of the Company's common stock, which the Company believes results in the best estimate of the grant-date fair value of employee stock options because it reflects the market's current expectations of future volatility. Prior to January 1, 2010, due to limited historical information on the volatility of the Company's common stock, the Company determined the volatility for options based on an analysis of reported data for a peer group of companies that issued options with substantially similar terms. The expected volatility of options granted was determined using an average of the historical volatility measures of this peer group of companies for a period equal to the expected life of the option.

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

The expected life of options has been determined utilizing the simplified method as prescribed by ASC topic 718, *Compensation Stock Compensation*. The Company uses historical employee exercise and option expiration data to estimate the expected life assumption for the Black-Scholes grant-date valuation. The Company believes that this historical data is currently the best estimate of the expected term of a new option, and generally its employees exhibit similar exercise behavior.

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

The stock option activity under the 2000, 2007 and 2009 Plan for the three months ended March 31, 2010 is as follows:

|   | Options<br>Outstanding | Weighted<br>Average<br>Exercise Price | Remaining<br>Contractual<br>Term in Years | Aggregate<br>Intrinsic<br>Value |
|---|------------------------|---------------------------------------|---|---------------------------------|
| Options outstanding at December 31, 2009      | 2,099,179              | \$ 5.36                               | 7.8                                       | \$ 1,975,462                    |
| Granted                                       | 503,500                | 3.40                                  |   |                                 |
| Exercised                                     | (11,750)               | 1.12                                  |   |                                 |
| Cancelled                                     | (69,813)               | 5.72                                  |   |                                 |
| Options outstanding at March 31, 2010         | 2,521,116              | \$ 4.98                               | 8.0                                       | \$ 1,735,527                    |
| Options exercisable at March 31, 2010         | 837,459                | \$ 4.28                               | 6.7                                       | \$ 1,137,461                    |
| Options available for grant at March 31, 2010 | 1,697,838              |                                       |   |                                 |

For the three months ended March 31, 2010 and 2009, the Company recorded stock-based compensation expense of \$383,489 and \$336,693, respectively. At March 31, 2010, total unrecognized stock-based compensation expense expected to be charged to operations over the next four years is estimated to approximate \$4.4 million.

The intrinsic values (aggregate market value of the underlying common stock minus aggregate exercise price) of stock options exercised during the three months ended March 31, 2010 and 2009 were \$24,348 and \$8,500, respectively. The total fair value of options which became exercisable during the three months ended March 31, 2010 and 2009 was approximately \$183,000 and \$123,000, respectively.

Stock-based compensation expense related to stock options for the three ended March 31, 2010 and 2009 was allocated as follows:

|                            | Three months ended<br>March 31, |            |
|----------------------------|---------------------------------|------------|
|                            | 2010                            | 2009       |
| Research and development   | \$ 38,857                       | \$ 74,274  |
| Sales and marketing        | 44,773                          | 57,596     |
| General and administrative | 299,859                         | 204,823    |
| Total                      | \$ 383,489                      | \$ 336,693 |



**Table of Contents****8. COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) is defined to include all changes in stockholders' equity during the period other than those changes that result from investments by and distributions to stockholders. For the three months ended March 31, 2010 and 2009, the Company's comprehensive income (loss) is the sum of net income (loss) and the foreign currency translation adjustment, as follows:

|  | <b>For the three months ended<br/>March 31,</b> |                  |
|--|---|------------------|
|  | <b>2010</b>                                     | <b>2009</b>      |
| Net income (loss)                        | \$ (2,319,962)                                  | \$ 57,171        |
| Foreign currency translation adjustment  | 4,586   | (33,497)         |
| <b>Total comprehensive income (loss)</b> | <b>\$ (2,315,376)</b>                           | <b>\$ 23,674</b> |

**9. COMMON STOCK**

The Company reserved 4,218,954 and 2,852,168 shares at March 31, 2010 and 2009 for issuance upon exercise of options to purchase common stock.

**10. NET INCOME (LOSS) PER COMMON SHARE**

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

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2010</b>                             | <b>2009</b> |
| <b>Numerator:</b>                           |   |             |
| Net income (loss)                           | \$ (2,319,962)                          | \$ 57,171   |
| <b>Denominator:</b>                         |   |             |
| Basic weighted average shares               | 23,797,008                              | 23,698,639  |
| Dilutive effect of common stock equivalents |   | 143,885     |
| Diluted weighted average shares             | 23,797,008                              | 23,842,524  |

During the three months ended March 31, 2010 and 2009, the Company had 1.5 million and 1.7 million dilutive potential common shares in the form of stock options which were not included in the computation of net income per diluted share because these stock options would be anti-dilutive.

**11. SEGMENT INFORMATION**

The Company conducts its operations and manages its business in two reporting segments. The Company develops, designs, manufactures and markets (i) semiconductor sensor products ( sensor products ) based on micro-electromechanical systems (MEMS) technology and advanced integrated circuit design and (ii) sensor system solution products ( system solution products ) which incorporates sensors with on-board computing, wireless communications and systems and application software solutions. In making operating decisions, the Company's chief executive officer, who is the chief operating decision maker, considers the gross profit results of the sensor product unit and the system solution product unit separately, but utilizes enterprise wide operating expense and earning results.



**Table of Contents*****Revenues by product application***

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

|                  | <b>Three months ended<br/>March 31,</b> |                     |
|------------------|---|---------------------|
|                  | <b>2010</b>                             | <b>2009</b>         |
| Mobile phone     | \$ 1,255,961                            | \$ 3,578,810        |
| Consumer         | 906,044                                 | 1,319,787           |
| Automotive       | 2,437,563                               | 1,328,984           |
| Industrial/other | 2,672,425                               | 347,085             |
| <b>Total</b>     | <b>\$ 7,271,993</b>                     | <b>\$ 6,574,666</b> |

***Revenues and gross profit by product type***

The following table summarizes revenue by product categories.

|                          | <b>Three months ended<br/>March 31,</b> |                     |
|--------------------------|---|---------------------|
|                          | <b>2010</b>                             | <b>2009</b>         |
| <i>Revenue</i>           |   |                     |
| Sensor products          | \$ 4,958,066                            | \$ 6,574,666        |
| System solution products | 2,313,927                               |                     |
| <b>Total</b>             | <b>\$ 7,271,993</b>                     | <b>\$ 6,574,666</b> |
| <i>Gross profit</i>      |   |                     |
| Sensor products          | \$ 1,797,144                            | \$ 3,133,024        |
| System solution products | 1,048,350                               |                     |
| <b>Total</b>             | <b>\$ 2,845,494</b>                     | <b>\$ 3,133,024</b> |

***Revenues by geographical region***

Revenue by geographic region, based upon customer location, for the three month ended March 31, 2010 and 2009 was as follows:

|                        | <b>Three months ended<br/>March 31,</b> |                     |
|------------------------|---|---------------------|
|                        | <b>2010</b>                             | <b>2009</b>         |
| Asia (excluding Japan) | \$ 2,528,094                            | \$ 4,602,970        |
| Europe                 | 725,035                                 | 422,037             |
| Japan                  | 1,155,208                               | 294,311             |
| North America          | 2,797,051                               | 1,255,348           |
| Other                  | 66,605                                  |                     |
| <b>Total</b>           | <b>\$ 7,271,993</b>                     | <b>\$ 6,574,666</b> |



**Table of Contents*****Total Assets by geographical region***

Total assets by geographical region are as follows:

|               | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---------------|---------------------------|------------------------------|
| United States | \$ 58,840,510             | \$ 59,028,075                |
| China         | 37,187,650                | 38,483,866                   |
| Japan         | 1,074,008                 |                              |
| Total         | \$ 97,102,168             | \$ 97,511,941                |

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

|               | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---------------|---------------------------|------------------------------|
| United States | \$ 6,298,472              | \$ 5,967,488                 |
| China         | 15,003,661                | 14,058,795                   |
| Total         | \$ 21,302,133             | \$ 20,026,283                |

**12. CONTINGENCIES**

On March 30, 2010, Honeywell International, Inc. filed a complaint in the United States District Court for the District of Massachusetts, in which it alleges that certain of the Company's magnetic sensor products infringe a United States patent held by Honeywell. The Company has not formed a conclusion as to whether a loss of any magnitude in this matter is probable, and is unable to estimate the range of potential loss, if any, that might arise from this matter.

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

**13. SUBSEQUENT EVENTS**

The Company evaluated subsequent events occurring after the balance sheet date, March 31, 2010, and concluded that there was no event of which management was aware that occurred after the balance sheet date that would require any adjustment to the accompanying consolidated financial statements.

**Table of Contents****Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

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

**OVERVIEW**

We provide advanced semiconductor sensors and system solutions based on integrated MEMS technology and mixed signal circuit design. Our accelerometer products are used to measure tilt, shock, vibration and acceleration, and have a wide range of applications such as mobile phones, automotive safety systems and video projectors. We combine proprietary thermal-based MEMS technology and advanced analog mixed signal processing circuitry design into a single chip using a standard CMOS process. In many instances, this approach allows us to provide sensor solutions at a lower cost, with higher performance and greater functionality than our competitors. In addition, our technology platform allows us to easily integrate additional functions or create new sensors to expand into magnetic, touch and flow sensors and related applications.

Any product that requires the control or measurement of motion is a potential application for accelerometers. For example, in mobile phones, accelerometers enable a variety of value-added functions such as image orientation, gaming control and text scrolling. In automotive applications, accelerometers are being deployed in airbag, electronic stability control, rollover protection, and navigation systems. In consumer applications, accelerometers are used in global positioning systems, video gaming systems and interactive toys. Industrial and medical applications include inclination sensing, earthquake detection and cardiac pacemakers.

We are a pioneer in providing accelerometers to China's fast-growing mobile phone market and are among the leading providers of accelerometers for image projectors, supplying to several Japanese original equipment manufacturers (OEM). Our largest automotive customer is Autoliv, Inc., a leading European automotive safety systems supplier. We are also capitalizing on our proprietary MEMS technology to develop new types of sensor solutions that will broaden our market opportunities. For example, our new line of MEMS-based magnetic sensors provides enhanced digital compass capabilities for mobile applications such as cell phones and personal navigation devices. Our industrial solutions business unit has developed a prototype for a MEMS-based gas-flow meter for use in industrial applications, primarily in the China market.

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Our recent acquisition of the non-military inertial navigation systems business and the wireless sensor network Mote and eKo environmental monitoring business, along with related intellectual property and fixed assets, from Crossbow Technology, Inc., a leading supplier of wireless sensor technology and inertial MEMS sensors for navigation and control, has significantly strengthened our capability to develop integrated sensing systems that incorporate sensors with on-board computing, wireless communications and systems and application software solutions. The acquisition also broadened our customer base to include industrial and aerospace markets that we believe may offer higher margins and more stability than the mobile and consumer markets. We also believe that our strong presence in China provides us with an opportunity to introduce these newly acquired wireless sensor network and inertial systems products in the fast-growing Chinese market.

We expect that sales of our accelerometer products will continue to represent the greater portion of our revenue for the foreseeable future and sales of our first non-accelerometer products, including magnetic sensors, will continue to increase in 2010. We also expect to see continued revenue growth from our newly acquired system solution product lines.

We sell our products either to distributors, which then resell to OEMs and ODMs, or to OEM and ODM customers directly. Historically, a small number of our customers have accounted for a substantial portion of our revenue, and sales to our largest distributor customers and OEM and ODM customers have varied significantly. This significant variation is in part due to the fact that our sales are made on the basis of purchase orders rather than long-term contracts. Although our distributors generally provide us with non-binding rolling forecasts, our distributors generally have up to 30-45 days prior to delivery to cancel or reschedule shipments pursuant to our distribution agreements. This arrangement has added to the fluctuation and unpredictability of our sales. Because our products are a component or a module part of our customers' products, our sales performance is significantly affected by the sales performance of our customers' products. It is difficult for us to accurately forecast our product demand because in the case where we sell our products to distributors, we may not know the identity of the distributor's OEM and ODM customers and information regarding their demand.

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

We manufacture our sensor products utilizing a semi-fabless model by outsourcing the production of CMOS wafers and completing the post-CMOS MEMS process in-house. By outsourcing the standard CMOS manufacturing process, we are able to more efficiently manage our capital expenditures and cost of goods sold. We currently purchase the acquired system solution products from Crossbow Technology, Inc. under a 12-month manufacturing agreement entered into in connection with the acquisition. We plan to transition the manufacturing of the system solution products to our facility in Wuxi, China within the next 12-18 months with the goal of reducing the cost of production by leveraging our China manufacturing capacity and lower labor rate.

### *Description of Certain Line Items*

#### ***Net Sales***

Net sales represent gross revenue net of an allowance for the estimated amount of product returns and sales rebates from our customers. Sales to distributors are made pursuant to distributor agreements, which allow for the

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return of goods under certain circumstances. We recognize revenue in accordance with ASC topic 605-15, *Revenue Recognition*. While we sell our products to distributors as well as end customers, sales to distributors account for a significant amount of the total revenue.

Historically, our revenue has been derived primarily from shipments of our accelerometer products. The primary factors that affect our revenue are the sales volumes and average selling prices of our products. Growth in our net sales has generally been attributable to the increase in the unit volumes of our products, as the average selling prices of our products generally decline due to the following factors, among others:

The semiconductor market is highly competitive, and as a result, the average selling prices of particular products generally experience rapid declines over the course of their respective product and technology life cycles. This trend has been particularly evident in the market for mobile phone applications. We seek to mitigate the impact of this trend on our business by continuing to rapidly design, develop and sell new generations of products with additional functionalities to replace older generation products;

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

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

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

***Net Sales by Application***

In the first quarter of 2010, net sales from industrial and other applications were the largest component of our total sales, representing 36.7% of total net sales due to the addition of revenue from the Crossbow acquisition. We expect that net sales from the industrial and other applications will continue to be a major component of our total sales in 2010.

Net sales from automotive applications continued to increase in the first quarter of 2010, primarily due to the increasing volume of our second automotive application in electronic stability control that commenced volume production in 2009. We expect our sales from automotive applications will continue to grow with our new application and the recovery of the auto market. To increase net sales from the automotive market, we will continue to seek to increase sales from new automotive applications and to expand our customer base. However, revenue increases, if any, from the automotive market will require significant time, as the development lead time in this market is generally longer than other markets in which we participate, and this market was disproportionately affected by the current global downturn.

Net sales from mobile phone applications decreased in the first quarter of 2010 due to severe price erosion and competition from mechanical switch and ball sensors. We intend to introduce a new ultra low cost product that is specially designed for cost sensitive applications like mobile phones, toys/games, digital cameras, flat panel TV s, appliances and other consumer electronics products that we believe will better enable us to compete with manufactures of mechanical switch and ball sensor products.

Net sales from consumer applications have fluctuated historically as a result of the generally short life cycle of consumer electronics and changes in our customer base. As our product offering and customer base for consumer applications continue to diversify, we expect net sales from consumer applications to fluctuate less.

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

|                  | Three months ended March 31, |               |                 |               |
|------------------|------------------------------|---------------|-----------------|---------------|
|                  | 2010                         |               | 2009            |               |
|                  | Amount                       | % of Sales    | Amount          | % of Sales    |
| Mobile phone     | \$ 1,256                     | 17.3%         | \$ 3,579        | 54.4%         |
| Consumer         | 906                          | 12.5          | 1,320           | 20.1          |
| Automotive       | 2,438                        | 33.5          | 1,329           | 20.2          |
| Industrial/other | 2,672                        | 36.7          | 347             | 5.3           |
| <b>Total</b>     | <b>\$ 7,272</b>              | <b>100.0%</b> | <b>\$ 6,575</b> | <b>100.0%</b> |

**Net Sales by Customer Base**

Our customers primarily consist of distributors, OEMs and ODMs. Historically, a small number of our customers have accounted for a substantial portion of our net sales. However, the Crossbow acquisition has broadened our customer base and we expect that customer concentration will decline in the near term. We have customers representing 10% or more of our net sales, which combined accounted for approximately 30.2% and 71.7% of our net sales in the first quarter of 2010 and 2009.

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

**Net Sales by Product Type**

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

|                          | Three months ended March 31, |               |                 |               |
|--------------------------|------------------------------|---------------|-----------------|---------------|
|                          | 2010                         |               | 2009            |               |
|                          | Amount                       | % of Sales    | Amount          | % of Sales    |
| Sensor products          | \$ 4,958                     | 68.2%         | \$ 6,575        | 100.0%        |
| System solution products | 2,314                        | 31.8          |                 |               |
| <b>Total</b>             | <b>\$ 7,272</b>              | <b>100.0%</b> | <b>\$ 6,575</b> | <b>100.0%</b> |

**Net Sales by Geography**

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



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

|                        | Three months ended March 31, |            |          |            |
|------------------------|------------------------------|------------|----------|------------|
|                        | 2010                         |            | 2009     |            |
|                        | Amount                       | % of Sales | Amount   | % of Sales |
| Asia (excluding Japan) | \$ 2,528                     | 34.8%      | \$ 4,603 | 70.0%      |
| Europe                 | 725                          | 10.0       | 422      | 6.4        |
| Japan                  | 1,155                        | 15.9       | 294      | 4.5        |
| North America          | 2,797                        | 38.4       | 1,256    | 19.1       |
| Other                  | 67                           | 0.9        |          | 0.0        |
| Total                  | \$ 7,272                     | 100.0%     | \$ 6,575 | 100.0%     |

**Cost of Goods Sold**

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

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

Our system solution products are currently manufactured for us by Crossbow Technology, Inc. under a 12-month manufacturing agreement that we entered into in connection with the acquisition. We intend to transition the manufacturing of our system solution products to China, outsourcing most of the assembly process to third-party contract assembly vendors and performing final testing and programming functions in-house at our facility in Wuxi. We plan to transition the manufacturing of the wireless sensor network products first and then transition the manufacturing of inertial guidance systems products. We expect to complete the entire transition within 12 to 18 months.

**Gross Profit and Gross Margin**

Recently our gross profit and gross margin from our sensor product has tended to decrease due to a variety of factors, including average selling prices of our products, our product application mix, prices of wafers, excess and obsolete inventory, pricing by competitors, changes in production yields, and percentage of sales conducted through distributors. Our products for mobile phone applications, which are sold to distributor customers, have historically had lower margins than our products for automotive products, which are sold directly to our OEM and ODM customers, and this trend has accelerated recently. In addition, our price reduction for accelerometers used in mobile phone applications, which allowed us to reduce inventories of our existing mobile phone application product and prepare for the production of our first digital thermal orientation sensor (DTOS) product, contributed to the decrease in the sensor product gross margin for the first quarter of 2010. Notwithstanding the relatively lower margin in the mobile phone applications market, we will seek to increase our market share in that market by introducing improved ultra low cost DTOS products and new magnetic sensor products because of the significant potential for further revenue growth in the mobile phone applications market.

The gross margin from system solution products, representing the product lines that we acquired from Crossbow Technology, Inc. in the first quarter of 2010, largely reflects the negotiated prices at which we currently purchase the products from Crossbow Technology, Inc. under the manufacturing agreement we entered into in connection with the acquisition. We expect the gross margins for our system solution products to increase as we complete the transition to in-house manufacturing.

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### ***Research and Development Expenses***

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

Historically, research and development expenses have increased both in absolute terms and as a percentage of total net sales. We expect this trend to continue in 2010 as we seek to diversify into non-accelerometer products and also as a result of the addition of acquired Crossbow engineers in the first quarter of 2010.

### ***Sales and Marketing Expenses***

Sales and marketing expenses primarily consist of wages, salaries and commissions for our sales and marketing personnel; consulting expenses, primarily consisting of sales consulting services and software application consulting services; travel expenses; independent sales representatives commissions; office rental; market promotion and other expenses and stock-based compensation. We expect sales and marketing expense to increase in 2010 as we continue to invest in sales and marketing resources to develop new market applications, expand our sales marketing network, engage in additional marketing and promotional activities and as a result of the addition of sales and marketing employees acquired from Crossbow.

### ***General and Administrative Expenses***

General and administrative expenses primarily consist of salaries and wages for administrative personnel; costs for professional services, including legal, tax and accounting services; depreciation and amortization expenses for non-manufacturing equipment; travel and entertainment expenses; office supply and other office-related expenses; office rental expenses; other expenses, such as utilities, insurance and provision for accounts receivable; and stock-based compensation. We expect that our general and administrative expenses for 2010 in absolute terms will increase with the additional office in San Jose, California, increased legal and professional fees and amortization expense as a result of the acquisition.

### ***Other Income (Expense)***

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

### ***Provision for Income Taxes***

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

Net income attributable to non-controlling venture represents net income which is allocated to our 49% joint venture partner in the Crossbow Japan joint venture and is therefore, excluded from the income or loss of MEMSIC, Inc.

### ***U.S. Tax***

In the United States, we are subject to the federal income tax and the Massachusetts state income tax at approximate rates of 34% and 9.5%, respectively. At December 31, 2009, the Company had gross U.S. net operating loss carryforwards of \$2.7 million, which expire in the years 2028 and 2029. Included within this amount is approximately \$260,000 of excess tax deductions associated with non-qualified stock options that have been exercised. When these excess tax benefits actually result in a reduction to currently payable income taxes, the tax benefit will be recorded as an increase to additional paid-in capital. Our operating losses may be subject to limitations under provisions of the Internal Revenue Code.



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Our policy is to reinvest any earnings of MEMSIC Semiconductor in our Chinese operations. We have not provided for the U.S. income taxes that could result from the distribution of such earnings to the U.S. parent. If these earnings were ultimately distributed to the U.S. in the form of dividends or otherwise, or if the shares of MEMSIC Semiconductor were sold or transferred, we would be subject to additional U.S. income taxes on these undistributed earnings.

*PRC Tax*

Our PRC taxes primarily consist of enterprise income tax, value-added tax, and certain other miscellaneous taxes. As of December 31, 2009, our Wuxi subsidiary had no PRC NOL carryforwards available to offset future PRC enterprise income tax. Beginning in 2009, our Wuxi subsidiary entered into a three-year period at a 50% reduced income tax rate.

*Enterprise Income Tax*

PRC enterprise income tax is calculated based on taxable income determined under PRC accounting principles. In accordance with Income Tax of China for Enterprises with Foreign Investment and Foreign Enterprises, or the Foreign Enterprise Income Tax Law, and the related implementing rules, foreign investment enterprises, or FIEs, incorporated in the PRC are generally subject to an enterprise income tax rate of 33%.

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

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

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

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

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

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

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

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

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

On March 16, 2007, the National People's Congress approved and promulgated a new tax law named Enterprise Income Tax Law, which took effect beginning January 1, 2008. Under the new tax law, FIEs and domestic companies are subject to a uniform tax rate of 25%. The new tax law provides a five-year transition period starting from its effective date for those enterprises which were established before the promulgation date of the new tax law and which were entitled to a preferential lower tax rate under the then effective tax laws or regulations. In accordance with regulations issued by the State Council, the tax rate of such enterprises may gradually transition to the uniform tax rate within the transition period. For those enterprises which are enjoying tax holidays, such tax holidays may continue until their expiration in accordance with the regulations issued by the State Council. While the new tax law equalizes the tax rates for FIEs and domestic companies, preferential tax treatment would continue to be given to companies in certain encouraged sectors and to entities classified as high-technology companies especially supported by the PRC government, whether FIEs or domestic companies.

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

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

### *Other PRC Taxes*

Other miscellaneous PRC taxes primarily consist of property tax, land-use tax and stamp tax which are accounted for in our general and administrative expenses, and education surcharge, which is recorded as part of our cost of goods sold.

### *Crossbow Japan Taxes*

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

### *Critical Accounting Policies and Estimates*

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

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We consider all accounting policy to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the consolidated financial statements. For a discussion of the critical accounting policies that we consider to be the most sensitive and that require the most significant estimates and assumptions used in the preparation of our consolidated financial statements, see our Annual Report on Form 10-K for the year ended December 31, 2009, under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies. There has been no change in our critical accounting policies and estimates from those described in our Annual Report on Form 10-K for the year ended December 31, 2009.

**RESULTS OF OPERATIONS**

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

|  | For the Three Months Ended March 31,<br>2010 |  | 2009     |                   |
|--|--|--|----------|-------------------|
|  | Amount                                       | % of net<br>sales<br>(dollar amounts in thousands) | Amount   | % of net<br>sales |
| Net sales  | \$ 7,272                                     | 100.0%   | \$ 6,575 | 100.0%            |
| Cost of goods sold                                       | 4,426  | 60.9   | 3,442    | 52.3              |
| Gross profit   | 2,846  | 39.1   | 3,133    | 47.7              |
| Operating expenses:                                      |  |  |          |                   |
| Research and development                                 | 1,974  | 27.1   | 1,170    | 17.8              |
| Sales and marketing                                      | 1,071  | 14.7   | 577      | 8.8               |
| General and administrative                               | 2,324  | 32.0   | 1,423    | 21.6              |
| Total operating expenses                                 | 5,369  | 73.8   | 3,170    | 48.2              |
| Operating loss   | (2,523)                                      | (34.7)   | (37)     | (0.5)             |
| Other income:  |  |  |          |                   |
| Interest and dividend income                             | 117  | 1.6  | 258      | 4.0               |
| Other, net   | 18   | 0.2  | 3        | 0.1               |
| Total other income                                       | 135  | 1.8  | 261      | 4.1               |
| Earnings (loss) before income taxes                      | (2,388)                                      | (32.8)   | 224      | 3.6               |
| Provision (benefit) for income taxes                     | (116)  | (1.6)  | 167      | 2.5               |
| Net income (loss)  | (2,272)                                      | (31.3)   | 57       | 1.1               |
| Less: net income attributable to noncontrolling interest | 47   | 0.6  |          |                   |
| Net income (loss) attributable to MEMSIC, Inc.           | \$ (2,319)                                   | (31.9)%  | \$ 57    | 1.1%              |

*Quarter Ended March 31, 2010 Compared to Quarter Ended March 31, 2009*

**Net sales.** Our net sales increased by 10.6% to \$7.3 million for the three months ended March 31, 2010 from \$6.6 million in the corresponding period of 2009. This increase was primarily attributable to the addition of \$2.3 million in sales from the system solution products we acquired

from Crossbow, offset by a decrease of \$2.3 million

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in sales from our sensor products in mobile phone applications due to price reductions to reduce inventories on hand. Sales in automotive applications accounted for \$2.4 million for the three months ended March 31, 2010, compared to \$1.3 million in the corresponding period in 2009. The increase in sales in automotive applications was due to sales growth as a result of the increase in volume of a new application at one significant automotive customer.

**Cost of goods sold.** Our cost of goods sold increased by 28.6% to \$4.4 million for the three months ended March 31, 2010 from \$3.4 million for the corresponding period in 2009. This increase was primarily due to the increase in the volume of units sold.

**Gross profit and gross margin.** Our gross profit decreased by 9.2% to \$2.8 million for the three months ended March 31, 2010 from \$3.1 million in the corresponding period of 2009. Our gross margin decreased by 8.6% points to 39.1% for the three months ended March 31, 2010 from 47.7% in the corresponding period of 2009.

Our gross profits and gross margins by product type are shown in the following table (dollars in thousands)

|                          | Three months ended March 31, |              | 2009            |              |
|--------------------------|------------------------------|--------------|-----------------|--------------|
|                          | 2010                         | Margin %     | Gross Profit    | Margin %     |
| Sensor products          | \$ 1,797                     | 36.2%        | \$ 3,133        | 47.7%        |
| System solution products | 1,048                        | 45.3         |                 |              |
| <b>Total</b>             | <b>\$ 2,845</b>              | <b>39.1%</b> | <b>\$ 3,133</b> | <b>47.7%</b> |

Our gross profit and gross margin from our sensor products was \$1.8 million and 36.2% for the first quarter of 2010, compared to \$3.1 million and 47.7% in the corresponding period of 2009. The decrease was primarily due to the price reduction of our sensor products for the mobile phone applications in China market. The gross margin from our system solution products was 45.3% and had positive impact on the overall gross margin for the first quarter of 2010.

**Research and development.** Our research and development expenses increased by 68.7% to \$2.0 million for the three months ended March 31, 2010 from \$1.2 million in the corresponding period of 2009. This increase was primarily due to the addition of an engineering team and related expense as a result of the acquisition as well as the increase in the research and material costs related to developing new products and system solutions in this period as compared to the corresponding period of 2009. Research and development expenses, as a percentage of total net sales, increased to 27.1% for the three months ended March 31, 2010 from 17.8% for the corresponding period of 2009.

**Sales and marketing.** Our sales and marketing expenses increased by 85.6% to \$1.1 million for the three months ended March 31, 2010 from \$577,000 for the corresponding period of 2009. The increase was primarily due to the addition of a sales and marketing team in California as a result of the acquisition and the increase in headcount of the sales and marketing resources for our existing product lines. Sales and marketing expenses, as a percentage of total net sales, increased to 14.7% for the three months ended March 31, 2010 from 8.8% for the corresponding period of 2009.

**General and administrative.** Our general and administrative expenses increased by 63.3% to \$2.3 million for the three months ended March 31, 2010 from \$1.4 million in the corresponding period of 2009. This increase was primarily due to the addition of a California office and related office expense, the amortization expense of the acquired intangibles and the legal and professional cost related to the acquisition. General and administrative expenses, as a percentage of total net sales, increased to 32.0% for the three months ended March 31, 2010 from 21.6% for the corresponding period in 2009.

**Other income.** Our other income was \$117,000 for the three months ended March 31, 2010 compared to \$258,000 in the corresponding period of 2009. The decrease was primarily due to a decrease in interest income as a result of lower interest rates.

**Provision for income taxes.** Our income tax benefit was \$116,000 for the three months ended March 31, 2010 compared to an income tax provision of \$167,000 in the corresponding period of 2009. Our income tax benefit



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for the first quarter of 2010 reflected principally income tax benefit of \$122,000 related to the recognition of a research and development tax credit earned in China and the benefit of \$92,000 related to losses incurred by our Wuxi subsidiary at the effective rate of 12.5%. These amounts were partially offset by the recognition of a provision related to certain deferred tax liability in the U.S. and a provision related to the joint venture in Japan. Our income tax provision for the first quarter of 2009 reflected principally income tax expense of \$168,000 recorded by our Wuxi subsidiary, related to earnings in China, at the effective rate of 12.5%. Beginning in 2009, our Wuxi subsidiary started its three-year tax holiday period at one-half the unified tax rate of 25%, which will extend until 2011 at which time the rate will increase to 25%.

***LIQUIDITY AND CAPITAL RESOURCES***

As of March 31, 2010, our principal sources of liquidity consisted of cash and cash equivalents of \$47.8 million. Our principal uses of cash historically have consisted of payments to our suppliers for the costs related to the outsourcing of wafer fabrication and outsourced processing fees paid to and materials purchased from third parties, as well as payments for our manufacturing overhead, equipment purchases and manufacturing space expansion. Other significant cash outlays primarily consist of salaries, wages and commissions for our non-manufacturing related employees.

As of March 31, 2010, our investments included \$5.2 million (net of \$247,000 impairment loss taken at December 31, 2008) of auction rate securities. Auction rate securities are generally long-term fixed income instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined calendar intervals, typically every 7, 28, 35 or 49 days. Due to liquidity issues that have recently been experienced in global credit and capital markets, certain of the auction rate securities we hold have failed at auction, meaning that the amount of securities submitted for sale at auction exceeded the amount of purchase orders. If an auction fails, the issuer becomes obligated to pay interest at penalty rates, and all of the auction rate securities we hold continue to pay interest in accordance with their stated terms. However, the failed auctions create uncertainty as to the liquidity in the near term of these securities. As a result, we have classified the \$5.2 million of auction rate securities we held at March 31, 2010 as long-term investments.

Based on our expected operating cash flows and our other sources of cash, we do not expect the potential lack of liquidity in our auction rate securities classified as long-term investments to affect our ability to execute our current business plan in the foreseeable future. However, the principal represented by these investments will not be accessible to us until one of the following occurs: a successful auction occurs, the issuer redeems the issue, a buyer is found outside of the auction process or the underlying securities have matured. There can be no assurance that we would be able in the near term to liquidate these securities on favorable terms, or at all, and if we should require access to these funds sooner than we currently expect, our inability to sell these auction rate securities could adversely affect our liquidity and our financial flexibility.

We believe that our current cash and cash flow from operations will be sufficient to meet our anticipated cash needs, including working capital requirements and capital expenditures for at least the next twelve months. Our future cash requirements will depend on many factors, including our operating income, the timing of our new product introductions, the costs to maintaining adequate manufacturing capacity, the continuing market acceptance of our products, payment terms for major contracts and customers, or other changing business conditions and future developments, including any investments or acquisitions we may decide to pursue. If our existing cash is insufficient to meet our requirements, we may seek to sell additional equity securities, debt securities or borrow from banks. We cannot assure you that financing will be available in the amounts we need or on terms acceptable to us, if at all. The sale of additional equity securities, including convertible debt securities, would be dilutive to our stockholders. The incurrence of indebtedness would divert cash for working capital requirements and capital expenditures to service debt and could result in operating and financial covenants that restrict our operations and our ability to pay dividends to our stockholders. If we are unable to obtain additional equity or debt financing, our business, operations and prospects may suffer.

*Operating Activities*

Net cash used in operating activities for the three months ended March 31, 2010 was \$413,000, which was

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derived from a net loss of \$2.3 million, adjusted to reflect a net increase relating to non-cash items and a net increase relating to changes in balances of operating assets and liabilities. The adjustments relating to non-cash items, a net increase of \$1.1 million, were primarily due to depreciation and amortization expense of \$0.9 million and stock-based compensation expense of \$0.4 million, offset by an increase deferred tax asset of \$0.2 million. The adjustments related to changes in balances of operating assets and liabilities, a net increase in cash of \$0.8 million, were primarily attributable to a \$0.8 million reduction of inventories due primarily to increased unit sales and a \$0.9 million increase in accounts payable and accrued expenses, offset by a \$0.2 million increase in accounts receivable due to the increase in net sales over the four quarter of 2009 and a \$0.7 million increase in other assets, primarily due to an increase in certain prepaid expenses including insurance, VAT receivables and supplier deposits.

Net cash used by operating activities for the three months ended March 31, 2009 was \$554,000, which was derived from a net income of \$57,000, adjusted to reflect a net increase relating to non-cash items and a net decrease relating to changes in balances of operating assets and liabilities. The adjustments relating to non-cash items, a net increase of \$841,000, were primarily due to depreciation and amortization expense of \$517,000, stock-based compensation expense of \$337,000 and deferred income tax of \$13,000. The adjustments related to changes in balances of operating assets and liabilities, a net decrease in cash of \$1.5 million, were primarily attributable to a \$1.6 million increase in accounts receivable due to the increase in net sales especially near the end of the first quarter of 2009 compared to the fourth quarter of 2008, a \$550,000 increase in other assets, primarily due to an increase in certain prepaid expenses including insurance, VAT receivables and supplier deposits and a \$58,000 reduction in accounts payable and accrued expenses, offset by a \$709,000 reduction of inventories due primarily to increased unit sales in the China mobile phone market.

*Investing Activities*

Net cash used in investing activities for the three months ended March 31, 2010 was \$18.7 million, primarily consisting of payment of \$17.6 million, net of acquired cash of \$0.4 million for the Crossbow acquisition and purchase of property and equipment for expanding our manufacturing capacity of \$1.3 million, offset by proceeds from sale of investments of \$0.2 million.

Net cash provided in investing activities for the three months ended March 31, 2009 was \$0.9 million, primarily consisting of proceeds from sale of short-term investments of \$1.7 million, which was offset by the purchase of property and equipment for expanding our manufacturing capacity of \$0.8 million.

*Financing Activities*

Net cash used in the financing activities for the three months ended March 31, 2010 was \$43,700, reflected cash dividend of \$56,800 paid to the minority owner of the joint venture in Japan and proceeds of \$13,100 from exercise of options to purchase common stock.

Net cash provided by financing activities for the three months ended March 31, 2009 was \$1,500, reflected proceeds from exercise of options to purchase common stock.

*Off-Balance Sheet Arrangements*

We do not have any off-balance sheet financing arrangements, other than property and equipment operating leases, nor do we have any transactions, arrangements or other relationships with any special purpose entities established by us, at our direction or for our benefit.

**Item 3. Controls and Procedures***A. Evaluation of Disclosure Controls and Procedures*

Based on the evaluation of our disclosure controls and procedures (as defined in the Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) required by Exchange Act Rules 13a15(b) or 15d-15(b), our Chief Executive Officer and our Principal Financial and Accounting Officer have concluded that as of March 31, 2010, the end of the period covered by this report, our disclosure controls and procedures were effective.

**Table of Contents*****B. Changes in Internal Controls***

There were no changes in our internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f), that occurred during the quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

On March 30, 2010, Honeywell International, Inc. filed a complaint in the United States District Court for the District of Massachusetts, in which it alleges that certain of our magnetic sensor products infringe a United States patent held by Honeywell. We have not formed a conclusion as to whether a loss of any magnitude in this matter is probable, and is unable to estimate the range of potential loss, if any, that might arise from this matter.

**Item 1A. Risk Factors**

There has been no material change in the risk factors disclosed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The net proceeds to us of our initial public offering, after deducting underwriting discounts and offering expenses, were approximately \$60.2 million. Through March 31, 2010, we have applied approximately \$4.4 million of the net proceeds to fund capital expenditures for the expansion of our manufacturing facility in Wuxi, \$6.5 million to the construction of two new buildings adjacent to that facility and \$18.0 million to the Crossbow acquisition. We have invested the balance of \$31.3 million of the net proceeds from our initial public offering in money market funds and auction rate securities, pending other uses.

**Item 6. Exhibits**

| Exhibit No. | Description  | Filed with This Form 10-Q |                    | Incorporated by Reference |             | Exhibit No. |
|-------------|--|---------------------------|--------------------|---------------------------|-------------|-------------|
|             |  | Form                      | Filing Date        | Form                      | Filing Date |             |
| 3.1         | Second Amended and Restated Certificate of Incorporation of MEMSIC, Inc. | 8-K                       | December 19, 2007  |                           |             | 3.1         |
| 3.2         | Amended and Restated By-Laws of MEMSIC, Inc.                             | S-1/A                     | November 30, 2007  |                           |             | 3.4         |
| 4.1         | Form of common stock certificate.  | S-1/A                     | December 7, 2007   |                           |             | 4.2         |
| 4.2         | Fifth Amended and Restated Investor Rights Agreement.                    | S-1                       | September 28, 2007 |                           |             | 4.3         |

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|------|---|-----|----------------|
| 10.1 | 2010 Executive Officer Bonus Plan   | 8-K | March 12, 2010 |
| 31.1 | Chief Executive Officer certification required by Rule 13a-14(a)                            | X   |                |
| 31.2 | Principal Accounting Officer certification required by Rule 13a-14(a)                       | X   |                |
| 32.1 | Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350                    | X   |                |
| 32.2 | Principal Financial and Accounting Officer certification pursuant to 18 U.S.C. Section 1350 | X   |                |

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**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.

**MEMSIC, Inc.**

**Dated: May 14, 2010**

**By:**

**/s/ YANG ZHAO  
Yang Zhao  
Chief Executive Officer and President  
Principal Executive Officer**

**Dated: May 14, 2010**

**By:**

**/s/ PATRICIA NIU  
Patricia Niu  
Principal Financial and Accounting Officer**