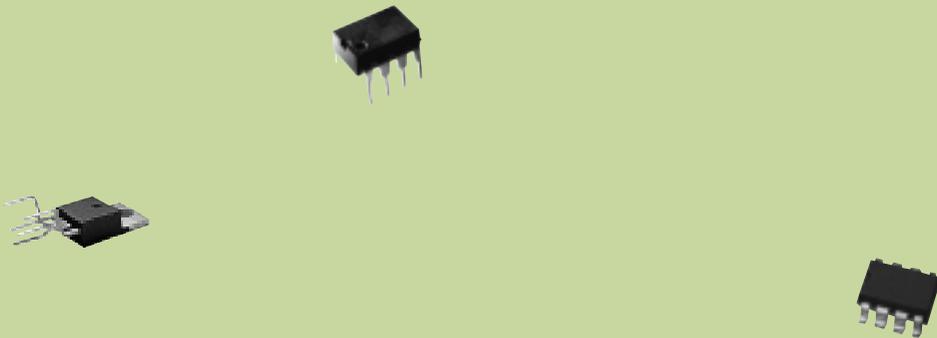
A hand holding a black remote control in a blurred living room setting with a television in the background.

The Laws of Natural Selection



POWER INTEGRATIONS, INC. (NASDAQ: POWI) IS A LEADING SUPPLIER OF HIGH-VOLTAGE ANALOG INTEGRATED CIRCUITS (ICS) USED IN POWER CONVERSION. THE COMPANY'S ICS HAVE ENABLED A NEW CLASS OF LIGHTWEIGHT, COMPACT, ENERGY-EFFICIENT POWER SUPPLIES FOR A WIDE RANGE OF POPULAR ELECTRONIC DEVICES.

THE COMPANY'S SUITE OF PRODUCTS ALLOW MANUFACTURERS TO COST EFFECTIVELY PRODUCE SMALLER, LIGHTER POWER SUPPLIES WITH A REDUCED NUMBER OF COMPONENTS ("HIGHLY INTEGRATED POWER SUPPLIES"). THE COMPANY'S PATENTED ECOSMART® TECHNOLOGY, WHICH HAS BEEN INCORPORATED IN ALL OF OUR ICS SINCE 1998, NOT ONLY ENABLES HIGHLY INTEGRATED POWER SUPPLIES, BUT DRAMATICALLY IMPROVES THEIR ENERGY EFFICIENCY.

ONE:

**Superior
Technology Will
Always Be The
Industry Standard**



THEN



NOW



Over Time, Consumers Naturally Select



THEN



NOW

Products With The Best Technology

THEN



NOW



Consumers Have Benefited From Technological Innovation



THEN



NOW

And Integration In Every Category Of Electronics...

THEN

12 oz.



NOW

2 oz.



Except One...

QUESTION:

Why shouldn't consumers benefit from the best technology in power supplies?

ANSWER:

Now more than ever consumers are demanding products that are smarter, more efficient and portable. Manufacturers are responding with higher performance products but continue to use bulky, outdated technology for the matching power supply. Electronic devices such as cellular phones, digital cameras, and MP3 players are hardly "portable" if you have to carry a battery charger that weighs more than a pound!

Imagine having power supplies that match these electronic products in size and weight. Our ICs are used in power supplies in numerous applications requiring 0.5 to 250 watts of power, including cellular telephones, set top boxes, personal computers, external peripherals, consumer video electronics and home appliances. Power Integrations is committed to bringing the classic benefits of semiconductor integration to the underserved AC to DC power supply market, enabling power supplies to better match the electronic products they serve. This marriage of equals fulfills the demands of consumers, manufacturers and governments worldwide.

Consumers want power supplies that complement their on-the-go lifestyles and portable products. Manufacturers want design simplicity, product differentiation and cost effectiveness. Governments want to ensure everyone benefits from the best technology available for energy-efficient products.

39

U.S. PATENTS

51

FOREIGN PATENTS

Power Integrations is a pioneer in integration and simplicity. Our patented breakthroughs allow a high level of integration on a single chip, eliminating up to 50 discrete components and dramatically simplifying power supply design. With 39 U.S. and 51 foreign patents, Power Integrations leads the industry in high-voltage integrated circuits for power conversion.

In 1994, Power Integrations introduced TOPSwitch[®], the first patented high-voltage analog integrated circuit (IC) family that facilitates a highly integrated and cost effective power supply solution. Since 1994, we have introduced the TinySwitch I/II and TOPSwitch FX/GX product families, further diversifying the electronic products we can serve. Our innovative ICs now enable cost effective, small, lightweight, energy-efficient power supplies for a broad range of applications.

Our patented monolithic process integrates a high-voltage, high-frequency MOSFET with standard 5 Volt CMOS and Bipolar mixed signal circuitry. Fewer components and integrated protection features significantly improve system reliability, reduce system complexity and accelerate time-to-market for our customers.

Our solution does not stop at the chip. We provide application support worldwide with local real-time technical assistance. In addition, our PI Expert[™] software automatically determines the components critical for optimizing a power supply, enhancing both an engineer's design effort and a product's time-to-market.

The power of 39 U.S. and 51 foreign patents – together with our total solutions approach – is transforming superior technology into the industry standard.

TWO:

Energy

**Efficiency Is No
Longer An Option**



Energy Efficient Standby Power Devices

By the authority vested in me as President by the Constitution and the laws of the United States of America, including the National Energy Conservation Policy Act (Public Law 95-619, 92 Stat. 3206, 42 U.S.C. 8252 et seq.), as amended by the Energy Policy Act of 1992 (EPACT) (Public Law 102-486, 106 Stat. 2776), and section 301 of title 3, United States Code, and in order to further encourage energy conservation by the Federal Government, it is hereby ordered as follows:

Section 1. Energy Efficient Standby Power Devices. Each agency, when it purchases commercially available, off-the-shelf products that use external standby power devices, or that contain an internal standby power function, shall purchase products that use no more than one watt in their standby power consuming mode. If such products are not available, agencies shall purchase products with the lowest standby power wattage while in their standby power consuming mode.

Agencies shall adhere to these requirements, when life-cycle cost-effective and practicable and where the relevant product's utility and performance are not compromised as a result. By December 31, 2001, and on an annual basis thereafter, the Department of Energy, in consultation with the Department of Defense and the General Services Administration, shall compile a preliminary list of products to be subject to these requirements. The Department of Energy shall finalize the list and may remove products deemed inappropriate for listing.

Sec. 2. Independent Agencies. Independent agencies are encouraged to comply with the provisions of this order.

Sec. 3. Definition. "Agency" means an executive agency as defined in 5 U.S.C. 105. For the purpose of this order, military departments, as defined in 5 U.S.C. 102, are covered by the Department of Defense.

George W. Bush
The White House,
July 31, 2001.



QUESTION:

Are the products you purchase energy efficient?

ANSWER:

Annually, U.S. households waste approximately \$4 billion of electricity to power devices such as computers, televisions, set-top boxes, microwave ovens and other everyday gadgets that people believe are turned “off.” Why aren’t electronics more energy-wise?

Some products, such as those that use Power Integrations’ EcoSmart-based chips, already give consumers an energy friendly option. As the rising demand for energy drives new product efficiency regulations and guidelines around the world, consumers will have even more opportunity to make the energy efficient choice.

Governments are beginning to take a more active role in curbing energy consumption and waste. On July 31, 2001, President Bush signed a Presidential Executive Order promoting reduced power consumption in almost all household electronics and appliances purchased by the Federal Government. Under the new rules these devices cannot consume more than one watt per hour when not in use.

Our chips already meet the proposed standby requirements and enable electronics and appliance manufacturers to cost effectively meet or exceed the new standards. For instance, in standby mode an average PC consumes 10 to 30 watts. This type of energy waste can be drastically reduced to less than one watt using Power Integrations’ EcoSmart-based chips.

Our ICs enable manufacturers of electronic products to give consumers the choice to purchase products that are energy efficient.

PC STANDBY CONSUMPTION NOW:

10-30

WATTS



POWER INTEGRATIONS ENABLES
PC STANDBY CONSUMPTION OF:

<1

WATT

Dear Stockholders,

I am pleased to be writing to you as the new President and CEO of Power Integrations. This is a very exciting period for the company and I am looking forward to my expanded role. With more than 12 years of experience at the company, I am more confident than ever that semiconductor technology in the form of smart high-voltage integrated circuits will transform the power supply market, just as ICs have become the industry standard for solutions in all other major electronic markets.

In 2001, we had many successes in the face of extremely challenging economic and industry conditions. We sustained profitability, strengthened our balance sheet and gained market share during a time when the competitive pricing environment has been more aggressive than ever. In addition, we expanded our product line to further diversify our customer base and broaden our addressable markets. We also strengthened our ability to win business and support a broader customer base by adding to our sales and engineering teams. In the area of intellectual property, we dramatically increased our patent portfolio to a total of 39 U.S. and 51 foreign patents.

We have an extremely talented team in place and we've worked hard to position the company for what we believe will be a pivotal growth phase for our future. Our vision remains clear: to convert old power conversion technologies such as linear transformers and discrete switchers to highly integrated IC-based solutions. Major market drivers such as portability, wireless connectivity and energy efficiency will hasten this conversion as we continue to introduce new products to broaden our customer base and diversify our end markets.

I am pleased to report sales of our newer products more than doubled during 2001, and we now forecast revenue from these products to increase from 40 percent of our total revenue in 2001 to approximately 60 percent in 2002. This is a very important milestone for us because these products dramatically expand our addressable markets.

We were also successful in continuing to diversify the markets our products can serve. For example, we had significant design activity for the first time in areas such as PC main power supplies, LCD monitors and projectors, DVD players and consumer audio products. The market acceptance of our new products continues to accelerate. We completed 2001 with revenue by market category as follows: Communications – 36 percent, Consumer – 31 percent, Computer – 19 percent, Industrial – 7 percent and All Other – 7 percent.

On the energy front, 2001 continued to bring heightened awareness to the need for energy efficiency. In June of 2001, I had the opportunity to give President Bush and Energy Secretary Spencer Abraham a demonstration about the significant amount of energy wasted by linear transformer-based power supplies (“vampires”) that come with electronic products. These “vampire” devices consume energy even when consumers believe that the product is turned “off.” This waste is equivalent to energy generated from 26 average-size power plants!

I demonstrated to the President that our EcoSmart™ chips virtually pull the plug on energy “vampires” by making electronic products more energy efficient. On July 31, 2001, the President issued an Executive Order (see page 11 of our Annual Report) promoting reduced standby power consumption in all electronic products purchased by the Federal Government. Under the new rules, these devices must consume one watt or less when not in use. Our technology is instrumental in enabling electronics and appliance manufacturers to meet these new standards.

The worldwide adoption of stricter energy guidelines is just one example of market forces that are compelling manufacturers to move to highly integrated power supplies. We also continue to see a push toward smaller, more portable and reliable power supplies. Our focus on market conversion remains unwavering. I am confident that our strategic actions are the ones required to accelerate this conversion to the best technology available.

Power Integrations pioneered integrated high-voltage power conversion and we have every intention to remain the market leader when ICs become the power supply technology of choice. Our team is focused and dedicated to making our solutions the industry standard. On behalf of the entire Power Integrations team, we thank you for your continued support.



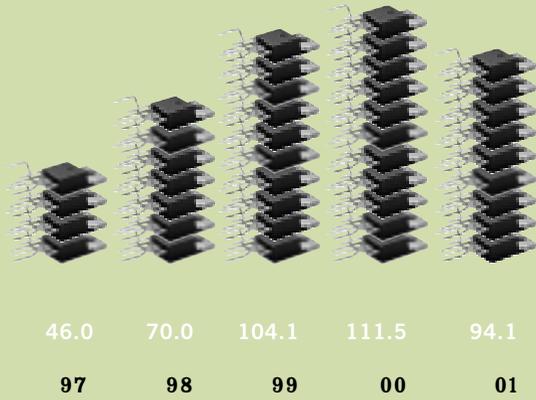
Balu Balakrishnan

Balu Balakrishnan
President and Chief Executive Officer
Power Integrations, Inc.

Financial Highlights

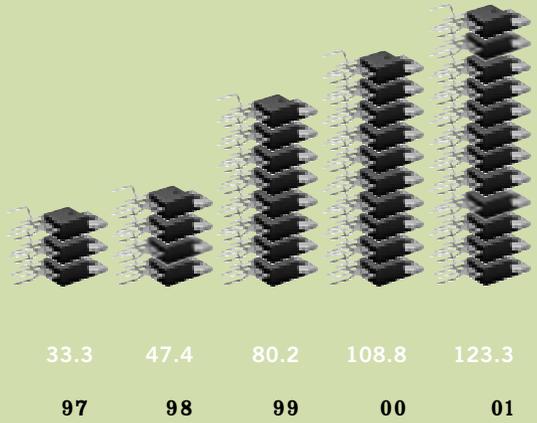
NET REVENUE

(IN MILLIONS)



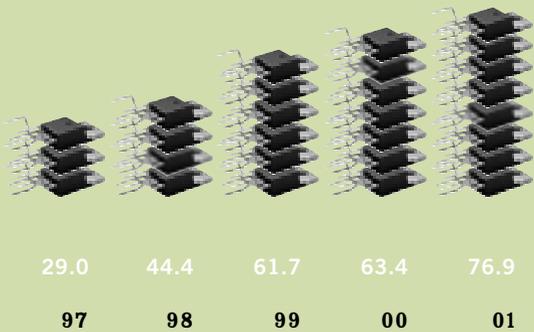
STOCKHOLDERS' EQUITY

(IN MILLIONS)

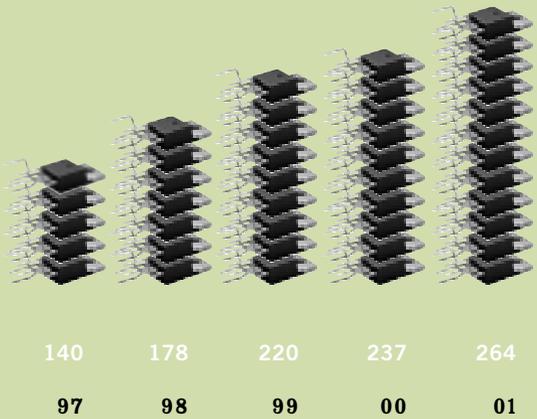


CASH AND INVESTMENTS

(IN MILLIONS)



NUMBER OF EMPLOYEES



POWER INTEGRATIONS:

**Financial
Information**

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2001

or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission File Number 0-23441

POWER INTEGRATIONS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
Incorporation or organization)

94-3065014
(I.R.S. Employer
Identification No.)

5245 Hellyer Avenue San Jose, California 95138-1002
(Address of principal executive offices) (Zip code)

(408) 414-9200

(Registrant's telephone number, including area code)

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

Title of each class

None

Name of Exchange on which registered

None

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

Common Stock, \$0.001 par value

(Title of Class)

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

The aggregate market value of registrant's voting and non-voting common equity held by nonaffiliates of registrant, based upon the closing sale price of the common stock on February 28, 2002, as reported on the NASDAQ National Market, was approximately \$333,346,300. Shares of common stock held by each officer, director and holder of 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Outstanding shares of registrant's common stock, \$0.001 par value, as of February 28, 2002: 28,156,942.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the definitive Proxy Statement for registrant's 2002 Annual Meeting of Stockholders to be filed with the Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Form are incorporated by reference into Part III of this Form 10-K Report.

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PART I

TOPSwitch, TinySwitch and EcoSmart are trademarks of Power Integrations, Inc.

Item 1. Business

Overview

We design, develop, manufacture and market proprietary, high-voltage, analog integrated circuits, commonly referred to as ICs, for use primarily in alternating current to direct current, or AC to DC, power conversion. We have targeted high-volume power supply markets including:

- the communications market;
- the consumer market;
- the computer market; and
- the industrial electronics markets.

Our initial focus is on those applications that are sensitive to size, portability, energy efficiency and time-to-market. We believe our patented TOPSwitch ICs, introduced in 1994, are the first highly integrated power conversion ICs to achieve widespread market acceptance. We introduced an enhanced family of ICs, TOPSwitch-II, in April 1997. In September 1998, we announced the TinySwitch family of integrated circuits for power supplies used in a broad range of electronic products. TinySwitch ICs, which are designed to reduce energy leakage by incorporating our new EcoSmart technology, enable a new class of light, compact, energy-efficient power supplies. In March 2000, we introduced the TOPSwitch-FX family of products, which also incorporates our EcoSmart technology to help engineers meet the growing need for environmentally friendly power solutions. In November 2000, we introduced the TOPSwitch-GX family of products. The GX family is capable of supplying output levels from 6 watts to 290 watts. We believe that the FX and GX families of ICs give power supply design engineers the ability to cost-effectively integrate additional functionality into the power supplies they design. In March 2001, we introduced the TinySwitch-II family of products with power levels ranging from 4 watts to 23 watts. All of our products introduced since 1998 incorporate our EcoSmart technology.

Industry Background

Virtually every electronic device that plugs into a wall socket requires some type of power supply to convert high-voltage AC, provided by electric utilities, into low-voltage DC required by the devices. Additionally, rechargeable, portable products, such as cellular phones and laptop computers, also need an AC to DC power supply to recharge their batteries.

Before 1970, AC to DC power supplies used large, inefficient transformers, which operated at low frequencies to convert power from AC to DC. In the 1970s, the invention of high-voltage discrete semiconductors enabled the development of a new generation of AC to DC “switching” power supplies, which allowed the use of smaller, more efficient transformers to lower the voltage. Although these discrete switchers offered advantages over older technologies, over the years they have not kept pace with the technological advances made in the electronic devices they power.

As the pressures from market forces have increased, the limitations of discrete switchers have become more pronounced. Discrete switchers require numerous components which limit the power supply designers’ ability to reduce the size, increase the functionality and improve the efficiency of switchers while at the same time meeting stringent market cost and energy efficiency requirements. In addition, discrete switchers involve a high level of design complexity, which limits the scalability of designs and increases time-to-market and development risks for new products.

Early attempts to replace discrete switchers with integrated switchers, using high-voltage analog ICs, did not achieve widespread acceptance in the marketplace because they were not cost-effective. We addressed this opportunity in 1994 by introducing our first cost effective IC, TOPSwitch. Our growth since that time validates our belief that a substantial market opportunity exists for high-voltage ICs that are cost effective and combine the benefits of integration that discrete switcher and earlier transformer technologies lack.

Our Highly Integrated Solution

We have developed several families of high-voltage power conversion ICs, which we believe are the first highly integrated power conversion ICs to achieve widespread market acceptance. Since introducing our TOPSwitch family of products in 1994, based on this and subsequent innovations, we have shipped into the market we pioneered approximately 680 million ICs. These patented ICs achieve a high level of system integration by combining a number of electronic components into a single IC. Our TOPSwitch and TinySwitch products enable many power supplies in the 0.5 to 290-watt power range to have a total cost equal to or lower than discrete switchers. Our TOPSwitch and TinySwitch products offer the following key benefits to power supplies:

- *Fewer Components, Reduced Size and Enhanced Functionality*

Our highly integrated TOPSwitch ICs enable the design and production of cost-effective switchers that use up to 50% fewer components and have enhanced functionality compared to discrete-based solutions. For example, our ICs provide thermal and short circuit protection without increasing system cost, while discrete switchers must add additional components and cost to provide these functions.

- *Improved Efficiency*

Our integrated circuit also improves electrical efficiency, which reduces power consumption and excess heat generation. Our patented low-loss, high-voltage device, combined with its control circuitry, improves overall electrical efficiency during both full operation and stand-by mode.

- *Reduced Time-to-Market*

Our integrated circuit makes power supply design simpler and once customers have created designs using our ICs, they can apply that design to new products, resulting in a shorter time-to-market and reduced product development risk.

- *Wide Power Range and Scalability*

Products in our current TOPSwitch and TinySwitch families can address a power range of 0.5 to 290 watts. Within each family of products, the switcher designer can scale up or down in power to address a wide range of designs with minimal design effort.

Strategy

Our objective is to be the leading provider of high-voltage power conversion ICs. We intend to pursue the following strategies to accelerate adoption of our products:

- *Target High-Volume Markets*

Because of our products' scalability and ability to address a wide power range, a small number of products address a wide variety of customer needs, allowing us to take advantage of economies of scale and making us more competitive.

- *Focus on Markets that Can Derive Significant Benefits from Integration*

We are initially focusing our efforts on those markets that are particularly sensitive to size, portability, energy efficiency and time to market issues. We achieved early success in the cellular phone fast charger market, as cellular phone customers demanded more portable travel chargers instead of stand-alone desktop chargers. We have also achieved success in the desktop PC market due to the market's demand for stand-by power capability, and in the cable and direct broadcast satellite decoder box market due to that market's need for reducing component count and for shortening product design cycles. As other significant market opportunities emerge for our TOPSwitch products, we intend to focus our resources on the development and penetration of those markets.

- *Deliver Systems Solutions and Provide Applications Expertise*

To help potential customers decide to purchase our TOPSwitch products, we offer comprehensive application design support. We provide extensive application notes, software design tools and reference design boards. We also provide application-engineering support out of our headquarters and through field application engineering labs located in China, England, Germany, India, Japan, Korea and Taiwan. We have committed substantial resources to system support by dedicating approximately 35 percent of our technical workforce to applications engineering. We believe our power supply systems expertise and investment in field applications engineering provide us significant competitive advantages.

- *Extend Technological Leadership in High-Voltage Analog ICs*

Our proprietary device structures and fabrication processes as well as circuit and system designs have resulted in 39 U.S. patents and 51 foreign patents. These patents, in combination with our other intellectual property, form the basis of our TOPSwitch and TinySwitch product families. We recently introduced an enhanced TOPSwitch product family that provides improved power capability and system cost advantages while preserving the design simplicity of our original TOPSwitch products. We continue to improve our device structures, wafer fabrication processes and circuit and system designs and seek to obtain additional patents to protect our intellectual property.

- *Leverage Patented Technology in Strategic Relationships*

We have established relationships with Matsushita Electronics Corporation, and with OKI Electric Industry in order to take advantage of these companies' high volume manufacturing resources, and in the case of Matsushita, to also generate royalty revenues. Our wafer manufacturing relationships with Matsushita and OKI enable us to focus on fundamental high-voltage silicon technology, product design and marketing while minimizing fixed costs and capital expenditures. Matsushita also has licensed the right to manufacture our products for sale in certain geographic regions and for use in its own products.

Products

Below is a brief description of our products:

- **TOPSwitch and TinySwitch Product Families**

Our TOPSwitch and TinySwitch high-voltage analog IC products are able to meet the power conversion needs of a wide range of applications within high volume markets. Sales of TOPSwitch and TinySwitch products accounted for 98%, 98% and 97% of our net revenues in 2001, 2000 and 1999, respectively.

* *TOPSwitch*

The TOPSwitch family was introduced in 1994 and consists of 13 products. The key benefits that the TOPSwitch family brings to power supplies, compared to discrete switchers, include fewer components, reduced size, enhanced functionality and lower cost in many applications. Our TOPSwitch products integrate a PWM controller, a high-voltage MOSFET and a number of other electronic components into a single 3 terminal IC.

* *TOPSwitch II*

The TOPSwitch II family was introduced in April 1997 and consists of 11 products. The TOPSwitch II products further lower the switcher costs by improving the performance of TOPSwitch and addressing low power applications with lower cost packaging. The TOPSwitch II family uses the same proprietary architecture as the original TOPSwitch family, enabling switcher designers experienced with TOPSwitch to take advantage of the TOPSwitch II benefits without implementing a new architecture.

* *TinySwitch*

The TinySwitch family was introduced in September 1998 and consists of 5 products. The product line topology was specifically designed to address low power applications below 10 watts. The TinySwitch family of high voltage ICs was the first family of chips to incorporate EcoSmart technology to address the growing global demand to reduce energy waste in a wide range of electronic products. It dramatically reduces the energy consumed during standby and no-load, enabling our customers to meet governmental energy efficiency guidelines.

* *TOPSwitch-FX*

The TOPSwitch-FX family was introduced in March 2000 and consists of 6 products. This family offers engineers greater design flexibility to develop highly integrated power supplies. New features integrated into the TOPSwitch-FX parts continue to reduce the system cost of power supplies as well as improve their performance. In addition, this product line incorporates our energy saving EcoSmart technology to help meet the growing need for environmentally friendly power solutions. The family delivers up to 75 watts of power for use in markets such as cellular phone chargers, personal computers, set-top boxes and DVD players.

* *TOPSwitch-GX*

The TOPSwitch-GX family was introduced in November 2000 and consists of 21 products. It is capable of supplying output power levels up to 290 watts. TOPSwitch-GX is the first monolithic high voltage switching power IC capable of providing this level of power. Our recently introduced novel, high-voltage technology further improves silicon efficiency of this family of devices by using dual-conduction layers. This structure provides a transistor conduction capability that results in a significantly more cost-effective high voltage device than that of competing technologies. The new family incorporates the features offered in earlier TOPSwitch product families as well as new ones through additional user configurable pins. This allows a higher level of end user design flexibility, resulting in improved power supply design optimization and lower system cost. Advanced EcoSmart technology offers improved standby energy efficiency. Applications for TOPSwitch-GX devices include set-top boxes, DVD players, desktop computers, LCD monitors, internet appliances and printers.

* *TinySwitch- II*

The TinySwitch-II family was introduced in March 2001 and consists of 4 products. This product line maintains the simplicity of the previous TinySwitch line while providing additional features and lowering system cost. This family of products is also implemented on the new dual conduction high voltage silicon technology and addresses power levels up to 23 watts. TinySwitch-II devices enable manufacturers to easily and cost effectively meet energy guidelines for standby power as outlined in Europe's EC Code of Conduct and the one watt standby executive order and Energy Star in the U.S. Applications for these devices include low power adaptors for portable equipment such as cell phones, PDAs, digital cameras, external computer peripherals, power tools, standby power supplies found in PCs and audio/video equipment and power supplies for home appliances.

- Other Products

Our products also include our SMP family, INT family and a limited number of custom products. Sales of these products accounted for 2%, 2% and 3% of our net revenues in 2001, 2000 and 1999, respectively. These products are scheduled for end-of-life at the end of 2002.

Markets and Customers

Our strategy is to target high-volume power supply applications and to initially focus on markets that can benefit the most from our highly integrated power conversion ICs. The following chart shows representative customers and end users and the primary applications of our products in power supplies in several major market categories.

<u>Market Category</u>	<u>Primary Applications</u>	<u>Customers</u>
<ul style="list-style-type: none">• <i>Communications</i>	cellular phones, wireless PDAs, cable modem, XDSL modems, network hubs, Telcom AC-DC, Telcom DC-DC	AcBel, Anam, Leader, Mitsubishi, Motorola, Nokia, Phihong, Quante, Salom, Samsung
<ul style="list-style-type: none">• <i>Consumer</i>	cable and DBS set top box, digital camera, DVD, TV standby, home comfort, major appliances, personal care and small appliances	Braun, Daewoo, General Electric, LG, Maytag, Miele, Mitsubishi, Pace, Philips, Samsung, Shinco, Sony, Whirlpool
<ul style="list-style-type: none">• <i>Computer</i>	desktop standby, desktop main, notebook adapter, monitors, multimedia audio, printer, removable media, LCD projector	AcBel, Artesyn, Astec, Compaq, Dell, Delta, Hipro, IBM, Liteon, Magnetek, Samsung
<ul style="list-style-type: none">• <i>Industrial Electronics</i>	industrial control, utility meters, motor control, uninterruptible power supply (UPS)	Actaris, American Power Conversion, Black & Decker, EBM Werke GmbH, Formosa Electronics, Samsung, Schlumberger, Siemens

Revenue by our end market categories for 2001 was approximately 36 percent communications, 31 percent consumer, 19 percent computer, 7 percent industrial electronics and 7 percent other markets.

Sales, Distribution and Marketing

We sell our products to original equipment manufacturers (OEMs) and merchant power supply manufacturers through a direct sales staff and through a worldwide network of independent sales representatives and distributors. Our international sales representatives also act as distributors in Europe and Asia. In the United States, we use two national distributors and a number of regional sales representatives. We have sales offices in California, Georgia and Illinois, as well as in China, England, Germany, India, Japan, Korea, Singapore and Taiwan. Direct sales to OEMs and merchant power supply manufacturers represented approximately 49%, 50% and 60% of our net product revenues for 2001, 2000 and 1999, respectively, while sales through distributors accounted for approximately 51%, 50% and 40% for 2001, 2000 and 1999, respectively. All distributors are entitled to certain return privileges based on sales revenue and are protected from price reductions affecting their inventories. Our distributors are not subject to minimum purchase requirements and the sales representatives and distributors can discontinue marketing any of our products at any time.

Our products are generally incorporated into a customer's power supply at the design stage. Our sales and marketing efforts are focused on facilitating the customer's use of our products in the design of new power supplies for specific applications. An important competitive factor in determining whether a customer decides to use our products in its designs is our commitment to provide comprehensive application design support. We publish comprehensive data books and design guides, and provide to our current and prospective customers extensive application notes and reference design boards. We also have available our "P I Expert" software, which is a PC-based design program that aids users in designing power supplies. In addition, we provide application-

engineering support out of our headquarters, and our field application engineering labs provide local resources to support customers in key geographies. We focus particular efforts on building relationships with, and providing support to, industry-leading OEMs and merchant power supply manufacturers. We have committed substantial resources to system support by dedicating approximately 35 percent of our technical workforce to applications engineering.

Our customer base is highly concentrated, and a relatively small number of distributors, OEMs and merchant power supply manufacturers, accounted for a significant portion of our revenue in 2001 and 2000. We estimate that our top ten customers, including distributors which resell to large OEMs and merchant power supply manufacturers, accounted for 74%, 69% and 68% of our net revenues for 2001, 2000 and 1999, respectively. For 2001, Memec Electronic Components and Synnex Technologies, both distributors, accounted for 22% and 13% of our net revenues, respectively. Also in 2001, Pihong Enterprise Co., a merchant power supply manufacturer, accounted for 11% of our net revenues. For 2000, Memec and Synnex accounted for 22% and 10% of our net revenues, respectively. For 1999, these two distributors accounted for 16% and 11% of our net revenues, respectively. No other customers accounted for more than 10% of net revenues during 2001, 2000 and 1999. In 2001, 2000 and 1999, international sales comprised 93%, 84% and 78%, respectively, of our net revenues.

Sales of our products are generally made pursuant to standard purchase orders, which are frequently revised to reflect changes in the customer's requirements. Product deliveries are scheduled upon our receipt of purchase orders. Generally, these orders allow customers to reschedule delivery dates and cancel purchase orders without significant penalties. For these reasons, we believe that purchase orders received, while useful for scheduling production, are not necessarily reliable indicators of future revenues.

Technology

- *High-Voltage Transistor Structure and Process Technology*

We have developed a patented high-voltage, power IC technology, which uses our proprietary high voltage MOS transistor structure and fabrication process and has resulted in 12 U.S. patents. The technology enables us to integrate cost effectively on the same monolithic IC, high-voltage n-channel transistors with industry standard CMOS and bipolar components. The IC device structure and the wafer fabrication process both contribute to the cost effectiveness of our high-voltage technology. Recently introduced novel, high-voltage technology further improves silicon efficiency of the devices by using dual-conduction layers. The device structure provides a transistor conduction capability that results in a significantly more cost-effective high voltage device than that of competing technologies. Our high voltage ICs have been implemented on low cost silicon wafers using standard 5V CMOS silicon processing techniques with a relatively large feature size of 3-microns combined with our proprietary implant process step.

- *IC Design and System Technology*

Our proprietary IC designs combine complex control circuits and high-voltage transistors on the same monolithic IC. Our IC design technology takes advantage of our high-voltage process to minimize the die size of both the high-voltage device and control circuits and improve the performance of our ICs versus alternative integrated technologies. We also have developed system expertise in switching converters that have resulted in new innovative topologies that reduce system cost, increase system performance and greatly improve energy efficiency of power supplies compared to alternative approaches. Our innovations in IC circuit designs system level architectures have resulted in 27 U.S. patents, and have enabled us to develop revolutionary products such as the highly integrated TOPSwitch, TOPSwitch-GX and TinySwitch family of ICs and scalable architecture for integrated switchers.

Research and Development

Our research and development efforts are focused on improving our high-voltage device structures, wafer fabrication processes, analog circuit designs and system level architecture. By these efforts, we seek to further

reduce the costs of our products, and improve the cost effectiveness and enhance the functionality of our customers' power supplies. We have assembled a multidisciplinary team of highly skilled engineers to meet our research and development goals. These engineers bring expertise in high-voltage structure and process technology, analog design and power supply systems architecture.

In 2001, 2000 and 1999, we spent \$14.5 million, \$12.5 million and \$10.8 million, respectively, on research and development efforts. We expect to continue to invest substantial funds in research and development activities. The development of high-voltage analog ICs is highly complex. We cannot guarantee that we will develop and introduce new products in a timely and cost-effective manner or that our development efforts will successfully permit our products to meet changing market demands.

Intellectual Property and Other Proprietary Rights

We use a combination of patents, trademarks, copyrights, trade secrets and confidentiality procedures to protect our intellectual property rights. We hold 39 U.S. patents and have generally filed for or received foreign patent protection on these patents resulting in 51 foreign patents to date. The U.S. patents have expiration dates ranging from 2006 to 2020. We are currently pursuing additional U.S. patent applications relating to new products and improvements, and extensions of our current products. We cannot guarantee that our pending United States or foreign patent applications or any future United States or foreign patent applications will be approved, that any issued patents will protect our intellectual property or will not be challenged by third parties, or that the patents of others will not have an adverse effect on our ability to do business. Furthermore, we cannot guarantee that others will not independently develop similar or competing technology or design around any of our patents. We also hold 18 trademarks, six in the U.S., two in California, two in Taiwan, one in Korea, two in Hong Kong, one in China, one in Europe and three in Japan.

We regard as proprietary certain equipment, processes, information and knowledge that we have developed and used in the design and manufacture of our products. Our trade secrets include a proprietary high volume production process that produces our patented high-voltage ICs. We attempt to protect our trade secrets and other proprietary information through non-disclosure agreements, proprietary information agreements with employees and consultants and other security measures. Despite these efforts, we cannot guarantee that others will not gain access to our trade secrets, or that we can meaningfully protect our intellectual property. In addition, effective trade secret protection may be unavailable or limited in certain foreign countries. Although we intend to protect our rights vigorously, we cannot assure that such measures will be completely successful.

We have granted a perpetual non-transferable license to Matsushita to use our semiconductor patents and other intellectual property for our current high-voltage technology, including our TOPSwitch technology and improvements on the existing technology, which allows Matsushita to manufacture and design products for internal use and for sale or other distribution to Japanese companies and to subsidiaries of Japanese companies in Asia. To the extent the products they manufacture and design are not based on the TOPSwitch technology, Matsushita may make sales or other distribution to Asian companies in Asia. Matsushita has granted us perpetual cross licenses to the technology developed by them under their license rights. We have agreed not to license the technology licensed to Matsushita to other Japanese companies or their subsidiaries prior to July 2005. In exchange for its license rights, Matsushita has paid and will continue to pay to us licensing fees for a fixed period and has paid or will pay royalties on products using the licensed technology during fixed periods.

We have also granted a perpetual, non-transferable license to AT&T Microelectronics to use certain of our IC processes and device technologies in the products AT&T sells. In addition, pursuant to an agreement with MagneTek, Inc., we have granted MagneTek an exclusive, non-transferable, perpetual royalty-free license to manufacture lighting products that incorporate certain of our technology.

Manufacturing

We contract with Matsushita and OKI to manufacture our wafers in foundries located in Japan. Our semiconductor products are assembled and packaged by independent subcontractors in China, Malaysia and the Philippines. We perform testing, finishing and shipping at our facility in San Jose, California. This fabless manufacturing model enables us to focus on our engineering and design strengths, minimize fixed costs on capital

expenditures, and still have access to high-volume manufacturing capacity. Our products do not require leading edge process geometries for them to be cost-effective, and thus we can use Matsushita and OKI's older, low-cost facilities for wafer manufacturing. We use a proprietary and sensitive implant process and must interact closely with Matsushita and OKI to achieve satisfactory yields. Although we generally utilize standard IC packages for assembly, some materials and aspects of assembly are specific to our products. We require our manufacturers to use a high-voltage molding compound that is difficult to process and is available from only one supplier. This compound and its required processes, together with the other non-standard materials and processes needed to assemble our products, require a more exacting level of process control than normally required for standard packages. As a result we must be involved with our contractors on an active engineering basis to maintain and improve the process. We have developed process monitoring equipment to support this effort and must provide adequate engineering resources to provide similar support in the future.

Our wafer supply agreements with Matsushita and OKI expire in June 2005 and September 2003, respectively. Under the terms of our agreement with Matsushita, we establish minimum annual and monthly purchase and sale commitments annually with the mutual agreement of Matsushita. We also establish pricing by good faith agreement, subject to our right to most favored pricing. Under the terms of the OKI agreement, OKI has agreed to reserve a specified amount of production capacity and to sell wafers to us at fixed prices, which are subject to periodic review jointly by OKI and us. Our agreements with both Matsushita and OKI provide for the purchase of wafers in Japanese yen. Both agreements allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar.

We cannot assure you that we will be able to reach an agreement with either Matsushita or OKI to extend the term of their respective wafer supply agreements. Failure to reach, in a timely fashion, an extension of either agreement or to enter into a wafer supply arrangement with another manufacturer could result in material disruptions in supply. Contractual provisions limit the conditions under which we can enter into such arrangements with other Japanese manufacturers or their subsidiaries during the term of the agreement with Matsushita. In the event of a supply disruption with OKI or Matsushita, if we were unable to quickly qualify alternative manufacturing sources for existing or new products or if these sources were unable to produce wafers with acceptable manufacturing yields, our operating results would suffer.

We typically receive shipments from Matsushita or OKI approximately 5 to 9 weeks after placing orders, and lead times for new products can be substantially longer. To provide sufficient time for assembly, testing and finishing, we typically need to receive wafers from Matsushita and OKI 4 to 6 weeks before the desired ship date to our customers. As a result of these factors and the fact that customers' orders can be made with little advance notice, we have only a limited ability to react to fluctuations in demand for our products. This could cause us to have excess or a shortage of inventory of a particular product. From time to time in the past we have been unable to fully satisfy customer requests as a result of these factors. Any significant disruptions in deliveries would materially adversely affect our business and operating results. We carry a substantial amount of inventory of tested wafers to help offset these factors to better serve our markets and meet customer demand.

Competition

The high-voltage power supply industry is intensely competitive and characterized by extreme price sensitivity. Accordingly, the most significant competitive factor in the target markets for our products is cost effectiveness. Our products face competition from alternative technologies, including traditional linear transformers and discrete switcher power supplies. We believe that at current pricing, our families of high-voltage power conversion ICs offer favorable cost-performance benefits compared to linear and discrete switcher supplies in many high-volume applications. However, there has been sizeable overcapacity of discrete components, which resulted in significant price erosion for these products during 2000 and 2001. A continuation of the price decline of discrete components, such as high-voltage Bipolar and MOSFET transistors and PWM controller ICs, could adversely affect the cost effectiveness of the TOPSwitch products. Also, older alternative technologies like linear transformers are more cost-effective than discrete switchers and integrated switchers that use our ICs in certain low power ranges for certain applications. If power requirements for certain applications in which our products are currently utilized, such as battery chargers for cellular telephones, drop below certain power levels, these older alternative technologies can be used more cost effectively than switchers. Our TinySwitch IC family, introduced in September 1998, was specifically designed to enhance the cost effectiveness of our integrated

switcher solutions in the low power range. However, we cannot guarantee that our efforts in this area will continue to be successful.

Recently, our TOPSwitch product families have begun to meet increased competition from hybrid and single high-voltage ICs similar to TOPSwitch. These competing products are being developed or have been developed and are being produced by companies such as ON Semiconductor, STMicroelectronics, Fairchild Semiconductor Infineon, Philips and Sanken Electric Company. We expect competition to increase as companies like these see the success we have had in converting older technologies to the integrated solutions enabled by our product offerings. To the extent these competitors' products are more cost effective than our products, our business, financial condition and operating results could be materially adversely affected. Many of our emerging competitors, including STMicroelectronics, Fairchild, Infineon, Philips and Sanken, have significantly greater financial, technical, manufacturing and marketing resources than do we. In the context of a market where a high-voltage IC is designed into a customer's product and the provider of such ICs is therefore the sole source of the IC for that product, greater manufacturing resources may be a significant factor in the customer's choice of the IC because of the customer's perception of greater certainty in its source of supply.

Our ability to compete in our target markets also depends on such factors as:

- timing and success of new product introductions by us and our competitors;
- the pace at which our customers incorporate our products into their end user products;
- availability of wafer fabrication and finished good manufacturing capability;
- availability of adequate sources of raw materials;
- protection of our products by effective utilization of intellectual property laws; and
- general economic conditions.

We cannot assure you that our products will continue to compete favorably or that we will be successful in the face of increasing competition from new products and enhancements introduced by existing competitors or new companies entering this market. Our failure to compete successfully in the high-voltage power supply business would materially adversely affect our business, financial condition and operating results.

Employees

As of December 31, 2001, we employed 264 full time personnel, consisting of 108 in manufacturing, 62 in research and development, 36 in applications support, 35 in sales and marketing and 23 in finance and administration.

Executive Officers of Power Integrations

As of February 28, 2002, our executive officers, which are elected by and serve at the discretion of the board of directors, were as follows:

<u>Name</u>	<u>Position With Power Integrations</u>	<u>Age</u>
Balu Balakrishnan	President and Chief Executive Officer	47
Derek Bell	Vice President, Engineering	58
John M. Cobb	Vice President, Finance and Administration, Chief Financial Officer	45
Richard S. Fassler	Vice President, Marketing	50
Bruce Renouard	Vice President, Worldwide Sales	41
Daniel M. Selleck	Vice President, Strategic Business Development	55
John Tomlin	Vice President, Operations	54
Clifford J. Walker	Vice President, Corporate Development	50
Howard F. Earhart	Chairman of the Board	62
Alan D. Bickell(1)(2)	Director	65
Nicholas E. Brathwaite(2)	Director	43
R. Scott Brown(1)	Director	60
E. Floyd Kvamme(1)(2)	Director	64
Steven J. Sharp	Director	60

(1) Member of the compensation committee

(2) Member of the audit committee

Balu Balakrishnan became the president and chief executive officer in January 2002. He served as our president and chief operating officer from April 2001 to January 2002. From January 2000 to April 2001, he was the vice president of engineering and strategic marketing. From September 1997 to January 2000 he was the vice president of engineering and new business development. From September 1994 to September 1997 Mr. Balakrishnan served as our vice president of engineering and marketing. He served as our vice president of design engineering from April 1989 to September 1994.

Derek Bell has served as vice president of engineering since joining us in April of 2001. Previously Mr. Bell was vice president of engineering for the professional services group at Synopsys during 1999 and 2000, vice president of strategic alliances at Cirrus Logic from 1996 to 1999, vice president and general manager of the application specific product group at National Semiconductor from 1995 to 1996 and served as president and chief executive officer of NovaSensor, a manufacturer of silicon sensors from 1990 to 1994. He also held various senior management positions at Signetics from 1972 to 1990, most recently as group vice president.

John M. Cobb has served as our vice president, finance and administration and chief financial officer since April 2001. From April 1990 to October 2000, Mr. Cobb held various senior level financial positions at Quantum Corporation, a computer storage company, most recently as vice president, finance and chief financial officer of the Hard Disk Drive Group.

Richard S. Fassler has served as our vice president, marketing since January 2000. From 1986 to 2000, Mr. Fassler held various positions, most recently as the vice president of sales and marketing at IXYS Corporation, a designer and developer of power semiconductors.

Bruce Renouard has served as our vice president, worldwide sales since February 2002. Mr. Renouard joined our company in January 2002 as a member of the sales organization. From August 1999 to August 2001,

he served as vice president, worldwide sales of Zoran Corporation, a provider of digital solutions in the multimedia and consumer electronics markets. Mr. Renouard held the position of director, worldwide market development from June 1997 to August 1999 for IDT/Centaur, an X 86 processor and start-up. From January 1995 to June 1997, he served as national distribution sales manager for Cyrix Corp, a company specializing in Intel compatible processors.

Daniel M. Selleck has served as our vice president, strategic business development since February 2002. He was our vice president, worldwide sales from May 1993 to February 2002. From February 1984 to May 1993, Mr. Selleck held various sales management positions with Philips Semiconductor including european regional sales manager and western area sales manager in the United States.

John Tomlin has served as our vice president, operations since October 2001. From 1981 to 2001, Mr. Tomlin served in a variety of senior management positions in operations, service, logistics and marketing, most recently as vice president of worldwide operations at Quantum Corporation, a computer storage company.

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

Howard F. Earhart served as our president, chief executive officer and as a director from January 1995 until January 2002, and continues as chairman of the board of directors. Mr. Earhart brings more than 30 years of executive management experience to Power Integrations. His management experience includes photographic film products at Eastman Kodak and consumer products at Memorex Corporation where he was president of the consumer products group. Mr. Earhart also served as the chief executive officer of Lin Data Corporation and Information Magnetics Corporation; both companies manufacture semiconductor-based components for the disk drive industry. Mr. Earhart currently serves on the boards of two private companies. He holds a B.S. in chemical engineering from Clarkson University.

Alan D. Bickell has served as a member of the board of directors since April 1999. Mr. Bickell retired in 1996 after more than 30 years with Hewlett Packard, serving as a corporate senior vice president and managing director of geographic operations since 1992. Mr. Bickell also serves on the boards of Asiainfo Holdings, Inc., Junior Achievement International and the Peking University Educational Foundation (USA).

Nicholas E. Brathwaite has served as a member of the board of directors since January 2000. Mr. Brathwaite currently serves as senior vice president and chief technology officer for Flextronics International, a provider of engineering, advanced electronics manufacturing and logistical services, and has held various engineering management positions with Flextronics since 1995. From 1989 to 1995, Mr. Brathwaite held various management positions at nChip, a multi-chip module company.

R. Scott Brown has served as member of the board of directors since July 1999. Mr. Brown has been retired since May 1999. From 1985 to May 1999, Mr. Brown served as senior vice president of worldwide sales and support for Xilinx, Inc., a designer and developer of complete programmable logic solutions for use by electronic equipment manufacturers.

E. Floyd Kvamme has served as a member of the board of directors since September 1989. Mr. Kvamme has been a general partner of Kleiner Perkins Caufield & Byers, a venture capital company, since 1984. Mr. Kvamme also serves on the boards of Brio Technology, Harmonic Inc., National Semiconductor, Photon Dynamics and several private companies.

Steven J. Sharp is one of our founders and has served as a member of the board of directors since our inception. Mr. Sharp has served as president, chief executive officer and chairman of the board of TriQuint Semiconductor, a manufacturer of electronic components for the communications industry, since September 1991.

Item 2. Properties.

Our main executive, administrative, manufacturing and technical offices are located in a 118,000 square foot facility in San Jose, California under a lease, which expires in September 2010 with two conditional five-year options which if exercised would extend the lease to September 2020.

Item 3. Legal Proceedings.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

PART II

Item 5. Market for Power Integration's Common Equity and Related Stockholder Matters.

Our common stock trades on the Nasdaq National Market under the symbol "POWI." As of February 28, 2002, there were approximately 120 stockholders of record. Because brokers and other institutions on behalf of stockholders hold many of such shares, we are unable to estimate the total number of stockholders represented by these record holders. The following table sets forth, for the quarter indicated, the range of daily closing prices per share of our common stock as reported on the Nasdaq National Market:

	<u>Price Range</u>	
	<u>High</u>	<u>Low</u>
<u>Year Ended December 31, 2001</u>		
Fourth quarter	\$ 27.10	\$ 16.58
Third quarter	\$ 25.71	\$ 15.36
Second quarter	\$ 22.79	\$ 12.10
First quarter	\$ 23.06	\$ 10.25
<u>Year Ended December 31, 2000</u>		
Fourth quarter	\$ 17.19	\$ 9.34
Third quarter	\$ 26.13	\$ 12.75
Second quarter	\$ 30.75	\$ 15.06
First quarter	\$ 65.63	\$ 22.75

All prices per share have been adjusted to reflect the 2-for-1 stock split we effected on November 22, 1999.

We have not paid any cash dividends on our capital stock. We currently intend to retain our earnings for use in the operation and expansion of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future.

Item 6. Selected Financial Data.

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and the Notes thereto included elsewhere in this Form 10-K.

	Years Ended December 31,				
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Net revenues:					
Product sales	\$92,919	\$109,759	\$102,655	\$68,206	\$44,827
License fees and royalties	<u>1,176</u>	<u>1,755</u>	<u>1,412</u>	<u>1,802</u>	<u>1,162</u>
Total net revenues	94,095	111,514	104,067	70,008	45,989
Cost of revenues	<u>51,252</u>	<u>53,876</u>	<u>46,794</u>	<u>36,638</u>	<u>26,291</u>
Gross profit	<u>42,843</u>	<u>57,638</u>	<u>57,273</u>	<u>33,370</u>	<u>19,698</u>
Operating expenses:					
Research and development	14,471	12,521	10,764	7,231	5,253
Sales and marketing	14,485	12,953	11,085	8,468	6,417
General and administrative	<u>5,980</u>	<u>6,451</u>	<u>8,760</u>	<u>3,641</u>	<u>2,053</u>
Total operating expenses	<u>34,936</u>	<u>31,925</u>	<u>30,609</u>	<u>19,340</u>	<u>13,723</u>
Income from operations	7,907	25,713	26,664	14,030	5,975
Interest and other income (expense), net	<u>1,749</u>	<u>2,523</u>	<u>2,147</u>	<u>1,248</u>	<u>(683)</u>
Income before provision for income taxes	9,656	28,236	28,811	15,278	5,292
Provision for income taxes	<u>2,930</u>	<u>8,471</u>	<u>4,334</u>	<u>2,600</u>	<u>530</u>
Net income	<u>\$6,726</u>	<u>\$19,765</u>	<u>\$24,477</u>	<u>\$12,678</u>	<u>\$ 4,762</u>
Earnings per share:					
Basic	<u>\$ 0.24</u>	<u>\$ 0.73</u>	<u>\$ 0.94</u>	<u>\$ 0.52</u>	<u>\$ 1.26</u>
Diluted	<u>\$ 0.23</u>	<u>\$ 0.69</u>	<u>\$ 0.87</u>	<u>\$ 0.48</u>	<u>\$ 0.25</u>
Shares used in per share calculation:					
Basic	<u>27,714</u>	<u>27,179</u>	<u>25,958</u>	<u>24,426</u>	<u>3,776</u>
Diluted	<u>28,991</u>	<u>28,774</u>	<u>28,197</u>	<u>26,452</u>	<u>18,678</u>
	December 31,				
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(in thousands)				
Consolidated Balance Sheets Data:					
Cash, cash equivalents and short-term investments	\$ 76,865	\$ 63,434	\$61,672	\$44,418	\$29,008
Working capital	\$100,836	\$ 87,005	\$71,169	\$42,988	\$30,131
Total assets	\$135,665	\$127,391	\$98,571	\$65,054	\$48,559
Long-term liabilities and capitalized lease obligations, net of current portion	\$ 716	\$ 715	\$ 1,393	\$ 1,963	\$ 2,435
Stockholders' equity	\$123,302	\$108,787	\$80,248	\$47,364	\$33,327

Item 7. Management’s Discussion and Analysis of Financial Condition and Operating Results.

This report includes a number of forward-looking statements. The use of such words and phrases as “will”, “expect”, “believe”, “should”, “anticipate”, “outlook”, “if”, “future” and similar words and phrases identify forward looking statements. Such statements reflect our current views with respect to future events and our potential financial performance and are subject to risks and uncertainties that could cause our actual results and financial position to differ materially from what we say in this report. These factors include, but are not limited to, our ability to maintain and establish strategic relationships; the risks inherent in the development and delivery of complex technologies; our ability to attract, retain and motivate qualified personnel; the emergence of new markets for our products and services, and our ability to compete in those markets based on timeliness, cost and market demand; and our limited financial resources. We make these forward looking statements based upon information available on the date hereof, and we have no obligation (and expressly disclaim any such obligation) to update or alter any forward looking statements, whether as a result of new information or otherwise. We more fully discuss these and other risk factors in “Item 7—Management’s Discussion and Analysis of Financial Condition and Operating Results— Factors That May Affect Future Results of Operations” and elsewhere in this report.

Overview

We design, develop, manufacture and market proprietary, high-voltage, analog ICs for use primarily in AC to DC power conversion primarily for the communications, consumer, computer and industrial electronics markets. From our inception in March 1988 through 1993, we developed numerous standard and custom products incorporating high levels of features and functionality, each intended to address the needs of various markets. Although we succeeded in developing the core of our patented technology during this period, market penetration of our products was low because these products were not as cost-effective as alternative products. Limited product revenue and the high costs associated with developing and marketing numerous solutions to numerous target markets resulted in our being unprofitable.

In 1993, we changed our strategy to focus on bringing cost-effective, integrated products to the high-voltage AC to DC power supply markets. As a result, in 1994, we completed development of TOPSwitch, the first in our family of cost effective, high voltage, power conversion ICs. The TOPSwitch family of products, with its proprietary integrated architecture, is designed to address with relatively few products broad applications in a number of high-volume, high-voltage AC to DC power supply markets. The initial target markets served by TOPSwitch are particularly sensitive to size, portability, energy efficiency and time-to-market. The TOPSwitch products and the solutions enabled by them are significantly lower in cost than our previous products and the solutions enabled by those products. Commercial shipments of TOPSwitch began in May 1994. As a result of the acceptance of TOPSwitch products, our net revenues from product sales were \$92.9 million, \$109.8 million and \$102.7 million in 2001, 2000 and 1999, respectively.

In response to increasing market acceptance of our TOPSwitch products and faster revenue growth in 1996, we accelerated our investment in research and development and sales and marketing, including technical customer support. Total operating expenses in 2001, 2000 and 1999 were \$34.9 million, \$31.9 million and \$30.6 million, respectively. For 2002, we expect our operating expenses to increase in absolute dollars as we continue to add resources to research and development, sales and marketing and general and administrative activities.

Our quarterly and annual operating results are volatile and difficult to predict. Our net revenues and operating results have varied significantly in the past, are difficult to forecast and are subject to numerous factors both within and outside of our control. As a result, our quarterly and annual operating results may fluctuate significantly in the future. For a discussion of the factors that may affect our quarterly and annual operating results, please see “Factors that May Affect Future Results of Operations.”

We license certain technologies and grant limited product manufacturing and marketing rights to strategic parties in return for foundry relationships, license fees and product royalty arrangements. Prior to the introduction of TOPSwitch in 1994, our analog ICs generated limited product sales while license fees and prepaid royalties accounted for a significant percentage of our total revenues. Since then license fees and royalties have consisted

primarily of royalties on products shipped by licensees incorporating licensed technology, and have accounted for a small percentage of our net revenues. We expect this trend to continue in 2002.

A portion of our cost of revenues consists of the cost of wafers. The contract prices to purchase wafers from Matsushita and OKI are denominated in Japanese yen. The agreements with both vendors allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. Nevertheless, changes in the exchange rate between the U.S. dollar and the Japanese yen subject our gross profit and operating results to the potential for material fluctuations.

Critical Accounting Policies

We believe our critical accounting policies are as follows:

- revenue recognition;
- estimating sales, returns and allowances;
- estimating ship and debit reserve;
- estimating allowance for doubtful accounts, and
- estimating reserve for excess and obsolete inventory.

A brief description of these policies is set forth below. For more information regarding our accounting policies, see note 2 in the notes to the consolidated financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, sales returns, allowance for ship and debit, bad debts and inventories. We base our estimates on historical facts and various other assumptions that we believe to be reasonable at the time the estimates are made. Actual results could differ from those estimates.

Revenue recognition

Product revenues consist of sales to OEMs, merchant power supply manufacturers and distributors. Revenues from product sales to OEMs and merchant power supply manufacturers are recognized upon shipment. At that time, we provide for estimated sales returns and other allowances related to those sales. Between 45% and 55% of our sales are made to distributors under terms allowing certain rights of return and price protection for our products held in the distributors' inventories. Therefore, we defer recognition of revenue and the proportionate cost of revenues derived from sales to distributors until the distributors sell our products to their customers. We evaluate the amounts to defer based on the level of actual distributors' inventory on hand as well as inventory that is in transit. The gross profit deferred as a result of this policy is reflected as "deferred income on sales to distributors" in the accompanying condensed consolidated balance sheets. See note 2 in the notes to consolidated financial statements.

Estimating sales returns and allowances

Net revenue consists of product revenue reduced by estimated sales returns and allowances. To estimate sales returns and allowances, we analyze historical returns, current economic trends, levels of inventories of our products held by our customers, and changes in customer demand and acceptance of our products when initially establishing and then evaluating quarterly the adequacy of the reserve for sales returns and allowances. This reserve is reflected as a reduction to accounts receivable in the accompanying consolidated balance sheets. Increases to the reserve are recorded as a reduction to net revenue. Because the reserve for sales returns and allowances is based on our judgments and estimates, particularly as to future customer demand and acceptance of our products, our reserves may not be adequate to cover actual sales returns and other allowances. If our reserves are not adequate, our net revenues could be adversely affected.

Estimating ship and debit reserve

A large portion of our sales is made to distributors. Under certain circumstances, some of those sales are subject to credits that distributors claim as protection against subsequent price declines on products they hold. The credits are referred to as “ship and debits.” The credits are available to the distributors after they have sold our products through to their end customer. We maintain a reserve for these credits that appears as a reduction to accounts receivable in our accompanying consolidated balance sheets. Any increase in the reserve results in a corresponding reduction in our net revenues. To establish the adequacy of the reserve, we analyze historical ship and debit payments and levels of inventory in the distributor channels. If our reserves are not adequate, our net revenues could be adversely affected.

Estimating allowance for doubtful accounts

We maintain an allowance for losses we may incur as a result of our customers’ inability to make required payments. Any increase in the allowance results in a corresponding increase in our general and administrative expenses. In establishing this allowance, and then evaluating the adequacy of the allowance for doubtful accounts, we analyze historical bad debt, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms. If the financial condition of one or more of our customers unexpectedly deteriorated, resulting in their inability to make payments, or if we otherwise underestimate the losses we incur as a result of our customers’ inability to pay us, we could be required to increase our allowance for doubtful accounts which could adversely affect our operating results.

Estimating reserve for excess and obsolete inventory

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

Results of Operations

The following table sets forth certain operating data as a percentage of total net revenues for the periods indicated.

	Percentage of Total Net Revenues For the Years Ended December 31,		
	2001	2000	1999
Net revenues:			
Product sales.....	98.8%	98.4%	98.6%
License fees and royalties.....	<u>1.2</u>	<u>1.6</u>	<u>1.4</u>
Total net revenues.....	100.0	100.0	100.0
Cost of revenues.....	<u>54.5</u>	<u>48.3</u>	<u>45.0</u>
Gross profit.....	<u>45.5</u>	<u>51.7</u>	<u>55.0</u>
Operating expenses:			
Research and development.....	15.4	11.2	10.3
Sales and marketing.....	15.4	11.6	10.7
General and administrative.....	<u>6.4</u>	<u>5.8</u>	<u>8.4</u>
Total operating expenses.....	<u>37.2</u>	<u>28.6</u>	<u>29.4</u>
Income from operations.....	8.3	23.1	25.6
Interest and other income, net.....	<u>1.9</u>	<u>2.2</u>	<u>2.1</u>
Income before provision for income taxes.....	10.2	25.3	27.7
Provision for income taxes.....	<u>3.1</u>	<u>7.6</u>	<u>4.2</u>
Net income.....	<u>7.1%</u>	<u>17.7%</u>	<u>23.5%</u>

Comparison of Years Ended December 31, 2001 and 2000

Net revenues. Net revenues consist of revenues from product sales, which are calculated net of returns and allowances, plus license fees and royalties paid by licensees of our technology. Net revenues decreased 15.6% to \$94.1 million in 2001 compared to \$111.5 million in 2000. Net revenues from product sales represented \$92.9 million and \$109.8 million of net revenues in 2001 and 2000, respectively. The decrease in net revenues from product sales was generally in all of our end markets and due primarily to the unfavorable economic conditions during the year. Our revenue mix for 2001 in the end markets which we serve was approximately 36% in the communications category, 31% in the consumer category, 19% in the computer category, 7% in the industrial electronics category and 7% in all other. Sales of our TOPSwitch and TinySwitch products represented 98% of net revenues from product sales in both 2001 and 2000. Net revenues from royalties were \$1.2 million in 2001 compared to \$1.8 million in 2000.

International sales were \$87.9 million in 2001 compared to \$93.7 million in 2000, representing approximately 93% and 84% of net revenues in those respective periods. Although the power supplies using our products are designed and distributed worldwide, most of these power supplies are manufactured in Asia. As a result, sales to this region were 76.6% and 66.7% of our product sales for 2001 and 2000, respectively. We expect international sales to continue to account for a large portion of our net revenues.

Direct sales for 2001 were divided 51.0% to distributors and 49.0% to OEMs, and merchant power supply manufacturers, compared to 50.0% to distributors and 50.0% to OEMs and merchant power supply manufacturers for 2000. In 2001, two separate customers, both of whom are distributors, accounted for approximately 22% and 13% of net revenues. Also in 2001, one other customer, a merchant power supply manufacturer accounted for approximately 11% of net revenues. In 2000, the same two distributors accounted for approximately 22% and 10% of net revenues, respectively. See note 2 in the notes to consolidated financial statements.

Cost of revenues; Gross profit. Gross profit is equal to net revenues less cost of revenues. Our cost of revenues consists primarily of costs associated with the purchase of wafers from Matsushita and OKI, the assembly and packaging of our products, and internal labor and overhead associated with the testing of both wafers and packaged components. Gross profit was \$42.8 million, or 45.5% of net revenues in 2001 compared to \$57.6 million, or 51.7% of net revenues, in 2000. The decrease in gross profit percentage for 2001 was due primarily to lower sales volumes, lower manufacturing efficiencies due to new product introductions and the adverse impact of increased pressure from customers for lower pricing. The decrease in gross profit was partially offset by a decrease in wafer costs and assembly costs. We expect our gross profit to remain in a range of 43% to 45% for 2002, but if pricing pressures from our customers increase during the year as a result of the economic slowdown or for other reasons, our gross profit could decline.

Research and development expenses. Research and development expenses consist primarily of employee-related expenses, and expensed material and facility costs associated with the development of new processes and new products. We also expense prototype wafers and mask sets related to new products as research and development costs until new products are released to production. Research and development expenses were \$14.5 million, or 15.4% of net revenues in 2001, compared to \$12.5 million, or 11.2% of net revenues in 2000. The increase for 2001 was due primarily to increased salaries and other costs related to the hiring of additional engineering personnel, outside consulting fees and higher facility costs. We expect research and development expenses to continue to increase in absolute dollars but depending on our ability to sell our products in the current economic environment, may fluctuate as a percentage of our net revenues.

Sales and marketing expenses. Sales and marketing expenses consist primarily of employee-related expenses, commissions to sales representatives and facilities expenses, including expenses associated with our regional sales and support offices. Sales and marketing expenses were \$14.5 million, or 15.4% of net revenues in 2001, compared to \$13.0 million, or 11.6% of net revenues in 2000. Included in these marketing expenses are costs associated with applications engineering in the amounts of \$3.7 million and \$2.7 million for 2001 and 2000, respectively. The increase in sales and marketing expenses for 2001 resulted primarily from the addition of personnel to support our sales effort and the increased activity in application engineering. We expect sales and

marketing expenses to increase in 2002, but depending on the general economic environment and resulting demand for our products, sales and marketing expenses may fluctuate as a percentage of our net revenues.

General and administrative expenses. General and administrative expenses consist primarily of employee-related expenses for administration, finance, human resources and general management, as well as consulting, outside services, legal and auditing expenses. In 2001 and 2000, general and administrative expenses were \$6.0 million and \$6.5 million, respectively, which represented 6.4% and 5.8% of net revenues in each respective period. The decrease in spending for general and administration expenses for 2001, was attributable primarily to a reduction in professional and legal expenses following the settlement in 2000 of our patent infringement lawsuit, which we had initiated with Motorola. For 2002, we expect general and administrative expenses to increase in absolute dollars but depending on the sales levels we are able to achieve given current economic conditions, they may fluctuate as a percentage of our net revenues.

Interest and other income, net. Interest and other income, net, was \$1.7 million and \$2.5 million in 2001 and 2000, respectively. The decrease for 2001 was due primarily to lower interest rates on our cash equivalents and short-term investments in 2001 compared to 2000, and an increase in costs attributable to foreign currency fluctuations.

Provision for income taxes. Provision for income taxes for 2001 and 2000 represents Federal, state and foreign taxes. The provision for income taxes was \$2.9 million for 2001 compared to \$8.5 million for 2000. Our estimated effective tax rate used for both 2001 and 2000 was 30%. The difference between the statutory rate of 35% and our effective tax rate is due primarily to the favorable effects of research and development tax credits, international sales, Federal tax-exempt investments and apportionment of state taxes, net of the federal benefit. See note 7 in the notes to consolidated financial statements for more information relating to our income tax.

Comparison of Years Ended December 31, 2000 and 1999

Net revenues. Net revenues increased 7.2% to \$111.5 million in 2000 compared to \$104.1 million in 1999. Net revenues from product sales represented \$109.8 million and \$102.7 million of net revenues in 2000 and 1999, respectively. The increase in net revenues from product sales was due primarily from our “other” end market category in which no one market represented more than 5% of our net revenues. Sales to the cellular phone market, which was our largest end market, accounted for approximately 30% of our net product revenues for 2000 compared to 39% of net product revenues in 1999. Sales of our TOPSwitch and TinySwitch products represented 98% and 97% of net revenues from product sales in 2000 and 1999, respectively. Net revenues from royalties were \$1.8 million in 2000 compared to \$1.4 million in 1999.

International sales were \$93.7 million in 2000 compared to \$81.6 million in 1999, representing approximately 84% and 78% of net revenues in those respective periods. Although the power supplies using our products are designed and distributed worldwide, most of these power supplies are manufactured in Asia. As a result, the largest portion of our net revenues is derived from sales to this region.

In 2000, two separate customers, both of whom are distributors, accounted for approximately 22% and 10% of net revenues. In 1999, the same customers accounted for approximately 16% and 11% of net revenues, respectively. See note 2 in the notes to consolidated financial statements.

Cost of revenues; Gross profit. Gross profit was \$57.6 million, or 51.7% of net revenues in 2000 compared to \$57.3 million, or 55.0% of net revenues, in 1999. In 2000, we experienced increased pricing pressures, which adversely affected our gross margins, and we had lower manufacturing efficiencies due to new product introductions. In 1999, gross profit benefited from a one-time credit from one of our wafer suppliers in the amount of \$1.4 million, which improved our gross profit by 1.3% for that year.

Research and development expenses. Research and development expenses were \$12.5 million, or 11.2% of net revenues in 2000, compared to \$10.8 million, or 10.3% of net revenues in 1999. The increase in absolute dollars was primarily the result of increased salaries and other costs related to the hiring of additional engineering personnel, outside consulting fees and expensed prototype materials resulting from the transition of foundry manufacturing processes, and bringing newly developed products into manufacturing.

Sales and marketing expenses. Sales and marketing expenses were \$13.0 million, or 11.6% of net revenues in 2000, compared to \$11.1 million, or 10.7% of net revenues in 1999. This increase in absolute dollars represented the addition of personnel to support international sales and field application engineers.

General and administrative expenses. In 2000 and 1999, general and administrative expenses were \$6.5 million and \$8.8 million, respectively, which represented 5.8% and 8.4% of net revenues in each respective period. The decrease in absolute dollars in general and administrative expenses in 2000 was primarily attributable to reduced professional and legal expenses related to the patent infringement lawsuit that we filed against Motorola in 1998.

Interest and other income, net. Interest and other income, net, was \$2.5 million and \$2.1 million in 2000 and 1999, respectively. The increase in other income reflected additional interest income related to the increase in cash equivalents and short-term investments from 1999 to 2000, and lower interest expense related to a reduction in our capital equipment lease obligations.

Provision for income taxes. Provision for income taxes for 2000 and 1999 represents Federal, state and foreign taxes. The effective tax rate was 30% for 2000 and 15% for 1999. The increased tax rate in 2000 is primarily because the impact of benefiting net operating loss carry-forwards ended in 1999. The difference between the statutory rate of 35% and our effective tax rate for 2000 is due primarily to the favorable effects of research and development tax credits, foreign sales corporation and apportionment of state taxes, net of the federal benefit. See note 7 in the notes to consolidated financial statements.

Selected Quarterly Results of Operations

The following tables set forth certain consolidated statements of operations data for each of the quarters in the years ended December 31, 2001 and 2000 as well as the percentage of our net revenues represented by each item. This information has been derived from our unaudited consolidated financial statements. The unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements contained herein and include all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of such information when read in conjunction with our annual audited consolidated financial statements and notes thereto appearing elsewhere in this report. The operating results for any quarter are not necessarily indicative of the results for any subsequent period or for the entire fiscal year.

	Three Months Ended							
	Dec. 31, 2001	Sept. 30, 2001	June 30, 2001	Mar. 31, 2001	Dec. 31, 2000	Sept. 30, 2000	June 30, 2000	Mar. 31, 2000
	(unaudited)							
	(in thousands, except per share data)							
Net revenues:								
Product sales.....	\$ 23,403	\$ 22,710	\$ 20,985	\$ 25,821	\$ 26,158	\$ 27,377	\$ 28,637	\$ 27,587
License fees and royalties.....	246	293	262	375	474	483	375	423
Total net revenues.....	23,649	23,003	21,247	26,196	26,632	27,860	29,012	28,010
Cost of revenues.....	13,486	13,092	11,893	12,781	13,287	13,280	13,867	13,442
Gross profit.....	10,163	9,911	9,354	13,415	13,345	14,580	15,145	14,568
Operating expenses:								
Research and development.....	3,643	3,586	3,696	3,546	2,951	3,084	3,431	3,055
Sales and marketing.....	3,339	3,797	3,839	3,510	2,968	3,139	3,438	3,408
General and administrative.....	1,707	1,537	1,434	1,302	1,286	1,743	1,505	1,917
Total operating expenses.....	8,689	8,920	8,969	8,358	7,205	7,966	8,374	8,380
Income from operations.....	1,474	991	385	5,057	6,140	6,614	6,771	6,188
Interest and other income, net.....	330	325	572	522	371	701	696	755
Income before provision for income taxes.....	1,804	1,316	957	5,579	6,511	7,315	7,467	6,943
Provision for income taxes.....	541	395	287	1,707	1,930	2,219	2,240	2,082
Net income.....	\$ 1,263	\$ 921	\$ 670	\$ 3,872	\$ 4,581	\$ 5,096	\$ 5,227	\$ 4,861
Earnings per share								
Basic.....	\$ 0.05	\$ 0.03	\$ 0.02	\$ 0.14	\$ 0.17	\$ 0.19	\$ 0.19	\$ 0.18
Diluted.....	\$ 0.04	\$ 0.03	\$ 0.02	\$ 0.14	\$ 0.16	\$ 0.18	\$ 0.18	\$ 0.17
Shares used in per share calculation								
Basic.....	27,951	27,758	27,620	27,522	27,418	27,325	27,210	26,756
Diluted.....	29,670	29,339	28,528	28,449	28,101	28,495	28,702	28,877

	Percentage of Total Net Revenues							
	Dec. 31, 2001	Sept. 30, 2001	June 30, 2001	Mar. 31, 2001	Dec. 31, 2000	Sept. 30, 2000	June 30, 2000	Mar. 31, 2000
Net revenues:								
Product sales.....	99.0%	98.7%	98.8%	98.6%	98.2%	98.3%	98.7%	98.5%
License fees and royalties.....	1.0	1.3	1.2	1.4	1.8	1.7	1.3	1.5
Total net revenues.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cost of revenues.....	57.0	56.9	56.0	48.8	49.9	47.7	47.8	48.0
Gross profit.....	43.0	43.1	44.0	51.2	50.1	52.3	52.2	52.0
Operating expenses:								
Research and development.....	15.5	15.6	17.4	13.5	11.1	11.1	11.8	10.9
Sales and marketing.....	14.1	16.5	18.1	13.4	11.1	11.3	11.9	12.2
General and administrative.....	7.2	6.7	6.7	5.0	4.8	6.2	5.2	6.8
Total operating expenses.....	36.8	38.8	42.2	31.9	27.0	28.6	28.9	29.9
Income from operations.....	6.2	4.3	1.8	19.3	23.1	23.7	23.3	22.1
Interest and other income, net.....	1.4	1.4	2.7	2.0	1.3	2.6	2.4	2.7
Income before provision for income taxes.....	7.6	5.7	4.5	21.3	24.4	26.3	25.7	24.8
Provision for income taxes.....	2.3	1.7	1.3	6.5	7.2	8.0	7.7	7.4
Net income.....	5.3%	4.0%	3.2%	14.8%	17.2%	18.3%	18.0%	17.4%

Net revenues increased sequentially in the first two quarters of 2000 and then decreased sequentially from the third quarter of 2000 through the second quarter of 2001 as we saw the effect of the global economic downturn. Net revenues increased slightly during the third and fourth quarters of 2001. We did not experience historical seasonal increases in the third and fourth quarters of 2000, due primarily to the impact of the weakening economy to our end markets during that time.

Our gross profit, as a percentage of net revenues, was relatively stable through 2000 and the first quarter of 2001. However, we experienced a decrease in gross profit beginning in the second quarter of 2001, and continuing through 2001, as a result of increased pricing pressures, lower sales volumes and lower manufacturing efficiencies due to new product introductions.

Research and development expenses generally increased in absolute dollars during the eight quarters presented, primarily due to increased staffing in the areas of new product design and technology development.

Sales and marketing expenses generally increased in absolute dollars over the first six quarters presented and then leveled off in the third and fourth quarters of 2001, primarily as a result of additional staffing required to support our sales offices and increased activity in application engineering.

General and administrative expenses generally decreased during 2000 as the legal costs related to a patent infringement lawsuit that we filed in a prior year declined. General and administrative expenses generally increased during 2001 due to additional personnel costs and increased outside professional services.

Interest and other income, net, generally trended down over the eight quarters presented, primarily from continuing decreases in interest rates over the periods. The significant decrease in the fourth quarter of 2000 was due to a one-time write off of abandoned leasehold improvements connected with the move to our new facilities in that quarter.

Liquidity and Capital Resources

Since our initial public offering of common stock in December 1997, our principal source of funding has been cash from our operations with some funding from capital equipment lease lines.

As of December 31, 2001, we had approximately \$76.9 million in cash, cash equivalents and short-term investments. In addition, under a revolving line of credit agreement with Union Bank of California, we can borrow up to \$10.0 million. A portion of the credit line is used to cover advances for commercial letters of credit and standby letters of credit, which we provide to Matsushita and OKI prior to the shipment of wafers by those foundries to us. The balance of this credit line is unused and available. The line of credit agreement contains financial covenants that we have remained in compliance with, and requires that we maintain profitability on a quarterly basis and not pay or declare dividends without the bank's prior consent. In previous years, we have financed a significant portion of our machinery and equipment through capital equipment leases. However, we did not obtain any additional financing through capital equipment leases in the years ended December 31, 2001 and 2000. We may obtain additional financing for equipment purchases in future quarters. As of December 31, 2001, we owed approximately \$715,000 on our various capital equipment leases.

As of December 31, 2001, we had working capital, defined as current assets less current liabilities, of approximately \$100.8 million, which was an increase of approximately \$13.8 million over December 31, 2000. Our operating activities generated cash of \$16.2 million and \$14.2 million in the years ended December 31, 2001 and 2000, respectively. Cash generated in the year ended December 31, 2001 was principally the result of net income in the amount of \$6.7 million, depreciation and amortization and decreases in accounts receivable and prepaid expenses and other current assets. This was partially offset by an increase in inventory and decrease in accounts payable. Cash generated in the year ended December 31, 2000 was principally the result of net income of \$19.8 million, depreciation and amortization and an increase in accrued liabilities, partially offset by increases in deferred income taxes, inventory and prepaid expenses.

Our investing activities were a net transfer from cash and cash equivalents to short-term investments of \$12.2 million and \$6.8 million for the years ended December 31, 2001 and 2000, respectively. We also purchased

capital assets in the amount of \$7.6 million and \$16.2 million for the years ended December 31, 2001 and 2000, respectively. The increase in purchases of capital assets in 2000 was primarily due to expenditures related to the purchase of tenant improvements at our new facilities in San Jose.

As of December 31, 2001, we have commitments through September 2010 for our operating and capital leases totaling approximately \$20.2 million. See note 4 in the notes to consolidated financial statements.

During 2001, a significant portion of our cash flow was generated by our operations. If our operating results deteriorate in 2002, as a result of decrease in customer demand or severe pricing pressures from our customers or our competitors, our ability to generate positive cash flow from operations may be jeopardized. In that case, we may be forced to use our cash, cash equivalents and short-term investments to fund our operations. We believe that cash generated from operations, together with existing sources of liquidity, will satisfy our projected working capital and other cash requirements for at least the next 12 months.

Recent Accounting Pronouncements

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses financial accounting and reporting for the long-lived assets to be held and used, and disposed of. The statement will be effective for financial statements issued for fiscal years beginning after December 15, 2001. We do not expect the adoption of SFAS No. 144 to have a material impact on our financial statements

Factors That May Affect Future Results of Operations

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

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

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

- the volume and timing of orders received from customers;
- the volume and timing of orders placed by us with our foundries;
- changes in product mix including the impact of new product introduction on existing products;
- our ability to develop and bring to market new products and technologies on a timely basis;
- the timing of investments in research and development and sales and marketing;
- cyclical semiconductor industry conditions; and
- fluctuations in exchange rates, particularly the exchange rates between the U.S. dollar and the Japanese yen.

Our quarterly results may be subject to seasonality. Historically, with the exception of 2000, our revenues generally have increased in our third quarters and then remained relatively flat in our fourth quarters, due to what we believe are seasonal factors attributed to the high volume consumer markets for the end products into which our ICs are sold. Our revenues have then followed a pattern of being sequentially linear or somewhat down in the first and second quarters of the following year.

We do not have long-term contracts with any of our customers and if they fail to place, or if they cancel or reschedule orders for our products, our operating results and business may suffer. Our business is characterized

by short-term customer orders and shipment schedules. The ordering patterns of some of our existing large customers have been unpredictable in the past and we expect that customer-ordering patterns will continue to be unpredictable in the future. Not only does the volume of units ordered by particular customers vary substantially from period to period, but also purchase orders received from particular customers often vary substantially from early oral estimates provided by those customers for planning purposes. In addition, customer orders can be canceled or rescheduled without significant penalty to the customer. In the past we have experienced customer cancellations of substantial orders for reasons beyond our control, and significant cancellations could occur again at any time.

Intense competition in the high-voltage power supply industry may lead to a decrease in the average selling price and reduced sales volume of our products, which may harm our business. The high-voltage power supply industry is intensely competitive and characterized by significant price erosion. Our products face competition from alternative technologies, including traditional linear transformers and discrete switcher power supplies. If the price of competing products decreases significantly, the cost effectiveness of our products will be adversely affected. If power requirements for applications in which our products are currently utilized go outside the cost effective range of our products, these older alternative technologies can be used more cost effectively. We cannot assure you that our products will continue to compete favorably or that we will be successful in the face of increasing competition from new products and enhancements introduced by existing competitors or new companies entering this market. We believe our failure to compete successfully in the high-voltage power supply business, including our ability to introduce new products with higher average selling prices, would materially harm our operating results.

If demand for our products declines in the major end markets that we serve, our net revenues will decrease. Applications of our products in the consumer, communications and computer end markets, such as cellular phone chargers, stand-by power supplies for PCs and main power supplies for TV set top boxes have and will continue to account for a large percentage of our net revenues. We expect that a significant level of our net revenues and operating results will continue to be dependent upon these applications in the near term. The demand for these products has been highly cyclical and has been subject to significant economic downturns at various times. The announcements of economic slowdown by major companies in some of the end markets we serve, indirectly through our customers, have caused a slowdown in demand for some of our ICs. When our customers are not successful in maintaining high levels of demand for their products, their demand for our ICs decreases, which adversely affects our operating results. Any significant downturn in demand in these markets would cause our net revenues to decline and could cause the price of our stock to fall.

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

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

We depend on third-party suppliers to provide us with wafers for our products and if they fail to provide us sufficient wafers, our business will suffer. We have supply arrangements for the production of wafers with

Matsushita and OKI. Although certain aspects of our relationships with Matsushita and OKI are contractual, many important aspects of these relationships depend on their continued cooperation and, in many instances, their course of conduct deviates from the literal provisions of the contracts. We cannot assure you that we will continue to work successfully with Matsushita or OKI in the future, that they will continue to provide us with sufficient capacity at their foundries to meet our needs, or that either of them will not seek an early termination of its wafer supply agreement with us. We estimate that it would take 9 to 12 months from the time we identified an alternate manufacturing source before that source could produce wafers with acceptable manufacturing yields in sufficient quantities to meet our needs.

Although we provide Matsushita and OKI with rolling forecasts of our production requirements, their ability to provide wafers to us is limited by the available capacity of the foundry in which they manufacture wafers for us. An increased need for capacity to meet internal demands or demands of other customers could cause Matsushita and OKI to reduce capacity available to us. Matsushita and OKI may also require us to pay amounts in excess of contracted or anticipated amounts for wafer deliveries or require us to make other concessions in order to acquire the wafer supply necessary to meet our customers' requirements. Any of these concessions could harm our business.

If our third-party suppliers and independent subcontractors do not produce our wafers and assemble our finished products at acceptable yields, our net revenues may decline. We depend on Matsushita and OKI to produce wafers, and independent subcontractors to assemble finished products, at acceptable yields and to deliver them to us in a timely manner. The failure of Matsushita or OKI to supply us wafers at acceptable yields could prevent us from selling our products to our customers and would likely cause a decline in our net revenues. In addition, our IC assembly process requires our manufacturers to use a high-voltage molding compound available from only one vendor, which is difficult to process. This compound and its required processes, together with the other non-standard materials and processes needed to assemble our products, require a more exacting level of process control than normally required for standard packages. Unavailability of the sole source compound or problems with the assembly process can materially adversely affect yields and cost to manufacture. We cannot assure you that acceptable yields will be maintainable in the future.

Matsushita has licenses to our technology, which it may use to our detriment. Our ability to take advantage of the potentially large Japanese market for our products is largely dependent on Matsushita and its ability to promote and deliver our products. Pursuant to our agreement with Matsushita, Matsushita has the right to manufacture and sell products using our technology to Japanese companies worldwide and to subsidiaries of Japanese companies located in Asia. Although we receive royalties on Matsushita's sales, these royalties are substantially lower than the gross profit we receive on direct sales. We cannot assure you that Matsushita will not use the technology rights we have granted it to develop or market competing products following any termination of its relationship with us or after termination of Matsushita's royalty obligation to us.

Our international sales activities subject us to substantial risks. Sales to customers outside of the United States account for a large portion of our net revenues. These sales involve a number of risks to us, including:

- potential insolvency of international distributors and representatives;
- reduced protection for intellectual property rights in some countries;
- the impact of recessionary environments in economies outside the United States;
- tariffs and other trade barriers and restrictions; and
- the burdens of complying with a variety of foreign laws.

Our failure to adequately address these risks could reduce our international sales, which would materially adversely affect our operating results. Furthermore, because substantially all of our foreign sales are denominated in U.S. dollars, increases in the value of the dollar increase the price in local currencies of our products in foreign markets and make our products relatively more expensive and less price competitive than competitors' products that are priced in local currencies.

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

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

We rely on a continuous supply of power to conduct operations, and California's current energy crisis could disrupt our business and increase our expenses. California has experienced an energy crisis and a reoccurrence could disrupt our operations and increase our expenses. In the event of an acute power shortage, that is, when power reserves for California fall below 1.5%, California has on some occasions implemented, and may in the future continue to implement, rolling blackouts throughout California. Most of our operations are located in California, although part of our inventory is stored and shipped from an overseas facility. We currently have only limited backup generators for emergency alternate sources of power in the event of a blackout. If blackouts interrupt our supply of power, we would be temporarily unable to continue operations at our facilities. Any such interruption in our ability to continue operations at our facilities could delay shipments of our products to customers, and could result in lost revenue, which could harm our business and results of operations.

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

In the event of an earthquake, terrorist act or other disaster, our operations may be interrupted and our business would be harmed. Our principal executive offices and operating facilities are located near San Francisco, California. This area has been subject to severe earthquakes. In the event of an earthquake, we may be temporarily unable to continue operations at our facilities and we may suffer significant property damage. Any such interruption in our ability to continue operations at our facilities could delay the development and shipment of our products.

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

If we are unable to adequately protect or enforce our intellectual property rights, we could lose market share, incur costly litigation expenses or lose valuable assets. Our success depends upon our ability to protect our intellectual property, including patents, trade secrets, and know-how, and to continue our technological innovation. We cannot assure you that the steps we have taken to protect our intellectual property will be adequate to prevent misappropriation or that others will not develop competitive technologies or products. From time to time we have received, and we may receive in the future, communications alleging possible infringement

of patents or other intellectual property rights of others. Litigation, which could result in substantial cost to us, may be necessary to enforce our patents or other intellectual property rights or to defend us against claimed infringement of the rights of others. The failure to obtain necessary licenses or other rights or litigation arising out of infringement claims could cause us to lose market share and harm our business.

Moreover, the laws of some foreign countries in which our technology is or may in the future be licensed may not protect our intellectual property rights to the same extent as the laws of the United States, thus increasing the possibility of infringement of our intellectual property.

We must attract and retain qualified personnel to be successful and competition for qualified personnel is intense in our market. Our success depends to a significant extent upon the continued service of our executive officers and other key management and technical personnel, and on our ability to continue to attract, retain and motivate qualified personnel, such as experienced analog design engineers and systems applications engineers. The competition for these employees is intense, particularly in Silicon Valley. The loss of the services of one or more of our engineers, executive officers or other key personnel or our inability to recruit replacements for these individuals or to otherwise attract, retain and motivate qualified personnel could harm our business. We do not have long-term employment contracts with, and we do not have in place key person life insurance policies on, any of our employees.

We have adopted anti-takeover measures, which may make it more difficult for a third party to acquire us. Our board of directors has the authority to issue up to 3,000,000 shares of preferred stock and to determine the price, rights, preferences and privileges of those shares without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of shares of preferred stock, while potentially providing flexibility in connection with possible acquisitions and for other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. We have no present intention to issue shares of preferred stock.

In February 1999, our board of directors adopted a Preferred Stock Purchase Rights Plan intended to guard against hostile takeover tactics. The adoption of this plan was not in response to any proposal to acquire us, and the board is not aware of any such effort. The existence of this plan could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock.

The future trading price of our common stock could be subject to wide fluctuations in response to a variety of factors. The price of our common stock has been, and is likely to be, volatile. Factors including future announcements concerning us or our competitors, quarterly variations in operating results, announcements of technological innovations, the introduction of new products or changes in our product pricing policies or those of our competitors, proprietary rights or other litigation, changes in earnings estimates by analysts and other factors could cause the market price of our common stock to fluctuate substantially. In addition, stock prices for many technology companies fluctuate widely for reasons, which may be unrelated to operating results. These fluctuations, as well as general economic, market and political conditions, may harm the market price of our common stock.

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

Interest Rate Risk. Our exposure to market risk for changes in interest rates relate primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We invest in high-credit quality issuers and, by policy, limit the amount of credit exposure to any one issuer. As stated in our policy, we ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in safe and high-credit quality securities and by constantly positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer, guarantor or depository. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity.

The table below presents the carrying value and related weighted average interest rates for our investment portfolio at December 31, 2001. All investments mature, by policy, in 15 months or less.

(in thousands, except average interest rates)

	<u>Amount</u>	<u>Weighted Average Interest Rate</u>
Cash Equivalents:		
U.S. corporate securities	\$ 44,800	3.28%
Tax-exempt securities	<u>2,500</u>	3.66%
Total cash equivalents	<u>47,300</u>	3.47%
Short-term Investments:		
U.S. corporate securities	\$ 8,818	3.14%
Tax-exempt securities	<u>5,906</u>	3.29%
Total short-term investments	<u>14,724</u>	3.21%
Total investment securities	<u>\$ 62,024</u>	3.34%

Foreign Currency Exchange Risk. We transact business in various foreign countries. Our primary foreign currency cash flows are in Japan and Western Europe. Currently, we do not employ a foreign currency hedge program utilizing foreign currency forward exchange contracts as the foreign currency transactions and risks to date have not been significant. We do maintain a Japanese yen account with a U. S. Bank for payments to suppliers and for cash receipts from Japanese suppliers and customers denominated in Japanese yen.

Item 8. Consolidated Financial Statements and Supplementary Data.

The Financial Statements and Supplementary Data required by this item are set forth at the pages indicated at Item 14(a).

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

None.

PART III

The SEC allows us to include information required in this report by referring to other documents or reports we have already or will soon be filing. This is called “Incorporation by Reference.” We intend to file our definitive proxy statement pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report, and certain information therein is incorporated in this report by reference.

Item 10. Directors and Executive Officers of the Registrant.

The information required by this Item is incorporated by reference to information set forth in our definitive proxy statement under the heading “Proposal No. 1—Election of Directors” and in Part I of this report under the heading “Executive Officers of the Registrant.”

The information required by this Item with respect to compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to information set forth in the definitive Proxy Statement under the heading “Executive Compensation and Other Matters.”

Item 11. Executive Compensation.

The information required by this Item is incorporated by reference to information set forth in our definitive proxy statement under the heading “Executive Compensation and Other Matters.”

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The information required by this Item is incorporated by reference to information set forth in our definitive proxy statement under the heading “Stock Ownership of Certain Beneficial Owners and Management.”

Item 13. Certain Relationships and Related Transactions.

The information required by this Item is incorporated by reference to information set forth in our definitive proxy statement under the heading “Certain Relationships and Related Transactions.”

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

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

1. Financial Statements

	<u>Page</u>
Report of Independent Public Accountants.....	34
Consolidated Balance Sheets	35
Consolidated Statements of Operations	36
Consolidated Statements of Stockholders' Equity.....	37
Consolidated Statements of Cash Flows	38
Notes to Consolidated Financial Statements.....	39

2. Financial Statement Schedules

All schedules, except Schedule II, Valuation and Qualifying Accounts, have been omitted because the required information is not present or not present in amounts sufficient to require submission of the schedules or because the information required is included in the Consolidated Financial Statements or Notes thereto.

3. Exhibits

See Index to Exhibits. The Exhibits listed in the accompanying Index to Exhibits are filed as part of this report.

(b) Reports on Form 8-K

None.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Power Integrations, Inc.:

We have audited the accompanying consolidated balance sheets of Power Integrations, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Power Integrations, Inc. and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed under Item 14 (a) is presented for purposes of complying with the Securities and Exchange Commission's rules and is not a part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

San Jose, California
January 18, 2002

POWER INTEGRATIONS, INC.
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2001 AND 2000
(In thousands, except share and per share amounts)

	2001	2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 62,141	\$ 36,462
Short-term investments	14,724	26,972
Accounts receivable, net of allowances of \$1,373 in 2001 and \$1,068 in 2000	5,124	9,189
Inventories	23,622	21,599
Deferred tax assets	5,346	6,054
Prepaid expenses and other current assets	<u>1,526</u>	<u>4,618</u>
Total current assets	<u>112,483</u>	<u>104,894</u>
PROPERTY AND EQUIPMENT, AT COST:		
Machinery and equipment	34,892	28,832
Leasehold improvements	<u>10,731</u>	<u>9,278</u>
	45,623	38,110
Less: Accumulated depreciation and amortization	<u>(22,441)</u>	<u>(15,613)</u>
	<u>23,182</u>	<u>22,497</u>
	<u>\$135,665</u>	<u>\$127,391</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of capitalized lease obligations	\$ 440	\$ 678
Accounts payable	4,641	7,490
Accrued payroll and related expenses	3,164	2,980
Taxes payable and other accrued liabilities	1,604	4,175
Deferred income on sales to distributors	<u>1,798</u>	<u>2,566</u>
Total current liabilities	<u>11,647</u>	<u>17,889</u>
LONG TERM LIABILITIES:		
Capitalized lease obligations, net of current portion	275	715
Deferred rent	<u>441</u>	<u>—</u>
Total long term liabilities	<u>716</u>	<u>715</u>
COMMITMENTS (NOTE 4)		
STOCKHOLDERS' EQUITY:		
Common Stock, \$0.001 par value		
Authorized— 140,000,000 shares		
Outstanding— 28,010,596 shares in 2001 and 27,430,367 shares in 2000	28	28
Additional paid-in capital	81,758	74,049
Stockholder notes receivable	(38)	(76)
Deferred compensation	—	(41)
Cumulative translation adjustment	(117)	(118)
Retained earnings	<u>41,671</u>	<u>34,945</u>
Total stockholders' equity	<u>123,302</u>	<u>108,787</u>
	<u>\$135,665</u>	<u>\$127,391</u>

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

POWER INTEGRATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999
(In thousands, except per share amounts)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
NET REVENUES:			
Product sales	\$ 92,919	\$109,759	\$102,655
License fees and royalties	<u>1,176</u>	<u>1,755</u>	<u>1,412</u>
Total net revenues	94,095	111,514	104,067
COST OF REVENUES	<u>51,252</u>	<u>53,876</u>	<u>46,794</u>
GROSS PROFIT	<u>42,843</u>	<u>57,638</u>	<u>57,273</u>
OPERATING EXPENSES:			
Research and development	14,471	12,521	10,764
Sales and marketing	14,485	12,953	11,085
General and administrative	<u>5,980</u>	<u>6,451</u>	<u>8,760</u>
Total operating expenses	<u>34,936</u>	<u>31,925</u>	<u>30,609</u>
INCOME FROM OPERATIONS	<u>7,907</u>	<u>25,713</u>	<u>26,664</u>
OTHER INCOME (EXPENSE):			
Interest income	2,103	3,049	2,515
Interest expense	(104)	(164)	(302)
Other, net	<u>(250)</u>	<u>(362)</u>	<u>(66)</u>
Total other income	<u>1,749</u>	<u>2,523</u>	<u>2,147</u>
INCOME BEFORE PROVISION FOR INCOME TAXES	9,656	28,236	28,811
PROVISION FOR INCOME TAXES	<u>2,930</u>	<u>8,471</u>	<u>4,334</u>
NET INCOME	<u>\$ 6,726</u>	<u>\$19,765</u>	<u>\$24,477</u>
EARNINGS PER SHARE:			
Basic	<u>\$ 0.24</u>	<u>\$ 0.73</u>	<u>\$ 0.94</u>
Diluted	<u>\$ 0.23</u>	<u>\$ 0.69</u>	<u>\$ 0.87</u>
SHARES USED IN PER SHARE CALCULATION:			
Basic	<u>27,714</u>	<u>27,179</u>	<u>25,958</u>
Diluted	<u>28,991</u>	<u>28,774</u>	<u>28,197</u>

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

POWER INTEGRATIONS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999
(In thousands)

	Common Stock		Additional Paid-In Capital	Warrants	Stockholder Notes Receivable	Deferred Compensation	Cumulative Translation Adjustment	Retained Earnings (Deficit)	Total Stockholders' Equity
	Shares	Amount							
BALANCE AT									
DECEMBER 31, 1998	24,994	\$ 25	\$ 57,276	\$ 12	\$ (274)	\$ (321)	\$ (57)	\$ (9,297)	\$ 47,364
Issuance of Common									
Stock under employee stock option plan, net of repurchases.....	769	1	1,678	—	—	—	—	—	1,679
Issuance of Common									
Stock under employee stock purchase plan	351	—	1,267	—	—	—	—	—	1,267
Exercise of warrants, net.....	354	—	12	(12)	—	—	—	—	—
Proceeds of stockholder									
note repayment.....	—	—	—	—	73	—	—	—	73
Income tax benefit from employee stock option plan....	—	—	5,320	—	—	—	—	—	5,320
Amortization of deferred compensation	—	—	—	—	—	140	—	—	140
Translation adjustment	—	—	—	—	—	—	(72)	—	(72)
Net income	—	—	—	—	—	—	—	24,477	24,477
BALANCE AT									
DECEMBER 31, 1999	26,468	26	65,553	—	(201)	(181)	(129)	15,180	80,248
Issuance of Common									
Stock under employee stock option plan, net of repurchases.....	704	2	2,919	—	—	—	—	—	2,921
Issuance of Common									
Stock under employee stock purchase plan	258	—	1,942	—	—	—	—	—	1,942
Proceeds of stockholder									
note repayment.....	—	—	—	—	125	—	—	—	125
Income tax benefit from employee stock option plan....	—	—	3,635	—	—	—	—	—	3,635
Amortization of deferred compensation	—	—	—	—	—	140	—	—	140
Translation adjustment	—	—	—	—	—	—	11	—	11
Net income	—	—	—	—	—	—	—	19,765	19,765
BALANCE AT									
DECEMBER 31, 2000	27,430	28	74,049	—	(76)	(41)	(118)	34,945	108,787
Issuance of Common									
Stock under employee stock option plan, net of repurchases.....	472	—	3,770	—	—	—	—	—	3,770
Issuance of Common									
Stock under employee stock purchase plan	109	—	1,707	—	—	—	—	—	1,707
Proceeds of stockholder									
note repayment.....	—	—	—	—	38	—	—	—	38
Income tax benefit from employee stock option plan....	—	—	2,232	—	—	—	—	—	2,232
Amortization of deferred compensation	—	—	—	—	—	41	—	—	41
Translation adjustment	—	—	—	—	—	—	1	—	1
Net income	—	—	—	—	—	—	—	6,726	6,726
BALANCE AT									
DECEMBER 31, 2001	<u>28,011</u>	<u>\$ 28</u>	<u>\$ 81,758</u>	<u>\$ —</u>	<u>\$ (38)</u>	<u>\$ —</u>	<u>\$ (117)</u>	<u>\$ 41,671</u>	<u>\$ 123,302</u>

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

POWER INTEGRATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999
(In thousands)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 6,726	\$ 19,765	\$ 24,477
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization.....	6,944	4,189	3,231
Deferred compensation expense.....	41	140	140
Deferred income taxes.....	708	(2,136)	(3,918)
Deferred rent.....	441	—	—
Provision for accounts receivable and other allowances.....	1,119	1,084	129
Change in operating assets and liabilities:			
Accounts receivable.....	2,946	(591)	(5,170)
Inventories.....	(2,023)	(10,193)	(2,561)
Prepaid expenses and other current assets.....	3,092	(3,197)	(610)
Accounts payable.....	(2,849)	966	656
Taxes payable and other accrued liabilities.....	(154)	4,989	5,716
Deferred income on sales to distributors.....	<u>(768)</u>	<u>(800)</u>	<u>800</u>
Net cash provided by operating activities.....	<u>16,223</u>	<u>14,216</u>	<u>22,890</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment.....	(7,629)	(16,214)	(6,592)
Purchases of short-term investments.....	(30,750)	(31,349)	(52,070)
Proceeds from sales and maturities of short-term investments.....	<u>42,998</u>	<u>38,166</u>	<u>38,524</u>
Net cash provided by (used in) investing activities.....	<u>4,619</u>	<u>(9,397)</u>	<u>(20,138)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from issuance of common stock.....	5,477	4,863	2,946
Proceeds from stockholder note repayment.....	38	125	73
Principal payments under capitalized lease obligations.....	<u>(678)</u>	<u>(1,228)</u>	<u>(2,064)</u>
Net cash provided by financing activities.....	<u>4,837</u>	<u>3,760</u>	<u>955</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS.....	25,679	8,579	3,707
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD.....	<u>36,462</u>	<u>27,883</u>	<u>24,176</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD.....	<u>\$62,141</u>	<u>\$36,462</u>	<u>\$27,883</u>
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Capitalized lease obligations incurred for property and equipment.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 772</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for interest.....	<u>\$ 65</u>	<u>\$ 161</u>	<u>\$ 312</u>
Cash paid for income taxes.....	<u>\$ 3,849</u>	<u>\$ 4,756</u>	<u>\$ 3,208</u>

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

POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001

1. THE COMPANY:

Power Integrations, Inc. (the "Company"), which was incorporated in California on March 25, 1988 and reincorporated in Delaware in December 1997 (see note 6), designs, develops, manufactures and markets proprietary, high-voltage, analog integrated circuits for use primarily in AC to DC power conversion that address the following major market segments: communications, consumer, computer and industrial electronics.

The Company is subject to a number of risks including, among others, the volume and timing of orders received by the Company from its customers; competitive pressures on selling prices; the volume and timing of orders placed by the Company with its foundries; the availability of raw materials; fluctuations in manufacturing yields, whether resulting from the transition to new foundries or from other factors; changes in product mix, including the impact of new product introductions on existing products; the Company's ability to develop and bring to market new products and technologies on a timely basis; the introduction of products and technologies by the Company's competitors; market acceptance of the Company's and its customers' products; the timing of investments in research and development and sales and marketing; cyclical semiconductor industry conditions; fluctuations in exchange rates, particularly exchange rates between the U.S. dollar and the Japanese yen; and changes in the international business climate and economic conditions.

All of the wafers used by the Company are manufactured by two offshore independent foundries. Although there are a number of other suppliers that could provide similar services, a change in suppliers could cause a delay in manufacturing and possible loss of sales, which could adversely affect operating results.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation and Foreign Currency Translation

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

Cash and Cash Equivalents and Short-Term Investments

The Company considers cash invested in highly liquid financial instruments with an original maturity of three months or less to be cash equivalents. Cash investments in highly liquid financial instruments with original maturities greater than three months but not longer than fifteen months are classified as short-term investments. As of December 31, 2001 and 2000, the Company's short-term investments consist of U.S. government backed securities, corporate commercial paper and other high quality commercial and municipal securities, which were classified as held-to-maturity and were valued using the amortized cost method which approximates market.

POWER INTEGRATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The table below summarizes the carrying value of the Company's investments by major security type (in thousands):

	<u>December 31,</u>	
	<u>2001</u>	<u>2000</u>
Cash Equivalents:		
U.S. corporate securities	\$ 44,800	\$ —
Tax-exempt securities	<u>2,500</u>	<u>25,950</u>
Total cash equivalents	<u>47,300</u>	<u>25,950</u>
Short-term Investments:		
U.S. corporate securities	\$ 8,818	\$ —
Tax-exempt securities	<u>5,906</u>	<u>25,949</u>
Total short-term investments	<u>14,724</u>	<u>25,949</u>
Total investment securities	<u>\$ 62,024</u>	<u>\$ 51,899</u>

Inventories

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

	<u>December 31,</u>	
	<u>2001</u>	<u>2000</u>
Raw materials	\$ 1,571	\$ 1,520
Work-in-process	12,528	13,409
Finished goods	<u>9,523</u>	<u>6,670</u>
	<u>\$23,622</u>	<u>\$21,599</u>

Property and Equipment

Depreciation and amortization of property and equipment are provided using the straight-line method over the shorter of the estimated useful lives of the assets (over a period of one to four years), or over the applicable lease term.

Included in property and equipment are assets acquired under capital lease obligations with an original cost of approximately \$2.9 million and \$4.4 million, as of December 31, 2001 and 2000, respectively. Related accumulated amortization on these leased assets was approximately \$2.7 million and \$3.3 million, as of December 31, 2001 and 2000, respectively.

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Earnings Per Share

Earnings per share are calculated in accordance with Statement of Financial Accounting Standards (SFAS) No. 128 "Earnings per Share." SFAS No. 128 requires companies to compute earnings per share under two different methods (basic and diluted). Basic earnings per share are calculated by dividing net income by the weighted average shares of common stock outstanding during the period. Diluted earnings per share are calculated by dividing net income by the weighted average shares of outstanding common stock and common stock equivalents during the period. Common stock equivalents included in the diluted calculation consist of dilutive shares issuable upon the exercise of outstanding common stock options and warrants computed using the treasury stock method.

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

	December 31,		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
Basic earnings per share:			
Net income	<u>\$ 6,726</u>	<u>\$19,765</u>	<u>\$24,477</u>
Weighted average common shares	<u>27,714</u>	<u>27,179</u>	<u>25,958</u>
Basic earnings per share	<u>\$ 0.24</u>	<u>\$ 0.73</u>	<u>\$ 0.94</u>
Diluted earnings per share:			
Net income	<u>\$ 6,726</u>	<u>\$19,765</u>	<u>\$24,477</u>
Weighted average common shares	27,714	27,179	25,958
Weighted average common share equivalents:			
Options	1,273	1,569	2,170
Employee stock purchase plan.....	<u>4</u>	<u>26</u>	<u>69</u>
Diluted weighted average common shares	<u>28,991</u>	<u>28,774</u>	<u>28,197</u>
Diluted earnings per share	<u>\$ 0.23</u>	<u>\$ 0.69</u>	<u>\$ 0.87</u>

Comprehensive Income

SFAS No. 130, "Reporting Comprehensive Income," establishes standards for reporting and the presentation of comprehensive income and its components. SFAS No. 130, requires companies to report a new measurement of income to include unrealized gains and losses, net of the tax effect that have historically been excluded from net income and reflected instead in stockholders' equity. Comprehensive income for the Company consists of net income plus the effect of foreign currency translation adjustments, which is not material for each of the three years ended December 31, 2001. Accordingly, comprehensive income closely approximates actual net income.

Segment Reporting

SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information." establishes standards for reporting and the presentation of reportable business segments, i.e., the management approach. This approach requires that business segment information used by management to assess performance and manage company resources be the source for information disclosure. On this basis, the Company is organized and operates as one business segment, the design, development, manufacture and marketing of proprietary, high-voltage, analog integrated circuits for use primarily in the AC to DC power conversion markets.

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Recent Accounting Pronouncements

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses financial accounting and reporting for the long-lived assets to be held and used, and disposed of. The statement will be effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company does not expect the adoption of SFAS No. 144 to have a material impact on its financial statements.

Revenue Recognition, Significant Customers

Product revenues consist of sales to OEMs and merchant power supply manufacturers and to distributors. Revenues from product sales to OEM and merchant power supply manufacturers are recognized upon shipment. The Company provides for estimated sales returns and allowances related to such sales at the time of shipment, which is based on historical returns, current economic trends, levels of inventories and changes in customer demand and acceptance of the Company's products. During 2001, 2000 and 1999, sales to distributors of the Company's products accounted for approximately 51%, 50% and 40% of net revenues, respectively. Sales to distributors are made under terms allowing certain rights of return and protection against subsequent price declines of the Company's products held by the distributors. Pursuant to the Company's distributor agreements, the Company protects its distributors' exposure related to the impact of price reductions as well as products at distributors that are slow moving or have been discontinued. These agreements, which may be canceled by either party on a specified notice, generally contain a provision for the return of the Company's product in the event the agreement with the distributor is terminated. Accordingly, the Company defers recognition of revenue and the proportionate costs of revenues derived from sales to distributors until such distributors resell the Company's products to their customers. The margin deferred as a result of this policy is reflected as "deferred income on sales to distributors" in the accompanying consolidated balance sheets.

The Company has entered into a separate wafer supply and technology license agreement with an unaffiliated wafer foundry. The wafer supply agreement, which expires in June 2005, is renewable. In connection with the technology license agreement, the Company is entitled to receive a royalty on sales of products by the foundry, which incorporates the Company's technology into its own products. For the years ended December 31, 2001, 2000 and 1999, revenue recognized under this agreement was approximately \$1.2 million, \$1.7 million and \$1.4 million, respectively.

The Company's end user base is highly concentrated and a relatively small number of OEMs, directly or indirectly through merchant power supply manufacturers, accounted for a significant portion of the Company's revenue. For the years ended December 31, 2001, 2000 and 1999, ten customers accounted for approximately 74%, 69% and 68% of net revenues, respectively.

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

<u>Customer</u>	<u>Year Ended December 31,</u>		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
A	22%	22%	16%
B	13%	10%	11%
C	11%	—	—

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Export Sales

The Company markets its products in North America and in foreign countries through its sales personnel and a worldwide network of independent sales representatives and distributors. Export sales, which consist of domestic sales to customers in foreign countries are comprised of the following:

	Year Ended December 31,		
	2001	2000	1999
Taiwan	31%	25%	19%
Hong Kong/China	27%	24%	20%
Western Europe.....	17%	17%	16%
Korea	10%	10%	13%
Japan	2%	2%	2%
Other	6%	6%	8%
Total export sales.....	93%	84%	78%

Product Sales

Sales of TOPSwitch and TinySwitch products accounted for 98%, 98% and 97% of total net revenues in 2001, 2000 and 1999, respectively. TOPSwitch products include TOPSwitch, TOPSwitch II, TOPSwitch-FX, and TOPSwitch-GX. TinySwitch products include TinySwitch and TinySwitch II. The Company's revenue mix for 2001 in the end markets which it serves was approximately 36% in the communications category, 31% in the consumer category, 19% in the computer category, 7% in the industrial electronics category and 7% in all other.

Foreign Currency Risk

The Company does not currently employ a foreign currency hedge program utilizing foreign currency forward exchange contracts, as the foreign currency translations and risks to date have not been significant. The Company maintains a Japanese yen bank account with a U.S. bank for payments to suppliers and for cash receipts from Japanese suppliers and customers denominated in yen. For the year ended December 31, 2001, the Company realized a foreign exchange transaction loss of approximately \$112,000. For the year ended December 31, 2000, the realized gains and losses netted to zero, and for the year ended December 31, 1999, the Company realized a foreign exchange transaction gain of approximately \$123,000. These amounts are included in "other income (expense)," in the accompanying consolidated statements of operations.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an on-going basis, the Company evaluates its estimates, including those related to revenue recognition and allowances for receivables and inventories. These estimates are based on historical facts and various other assumptions that the Company believes to be reasonable at the time the estimates are made.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash investments and trade receivables. The Company has cash investment policies that limit cash investments to short-term, low risk investments. With respect to trade receivables, the Company performs ongoing credit evaluations of its customers' financial condition and requires letters of credit whenever deemed necessary. Additionally, the Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends related to past losses and other relevant

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

information. As of December 31, 2001 and 2000, approximately 75% and 78% of accounts receivable, respectively, were concentrated with ten customers.

3. BANK LINE OF CREDIT:

The Company has a \$10.0 million revolving line of credit agreement with a bank, which expires on July 1, 2002, and restricts the Company from entering into certain transactions and contains certain financial covenants. Advances under the agreement bear interest at a fixed rate of the bank's LIBOR rate plus 1.5% per annum or at the bank's variable interest rate. The Company has the option to choose between the two rates. As of December 31, 2001 and 2000, there were no amounts due under the bank line of credit. The agreement also covers advances for commercial letters of credit and standby letters of credit, used primarily for the shipment of wafers from wafer supply manufacturers to the Company, provided that at no time will the aggregate sum of all advances exceed \$10.0 million. As of December 31, 2001, there were outstanding letters of credit totaling approximately \$3.8 million, and as of December 31, 2000, there were outstanding letters of credit totaling approximately \$3.4 million.

4. COMMITMENTS:

The Company leases its facilities under noncancellable operating leases, which expire at various dates through September 2010. The lease for the Company's main corporate facility in San Jose, California expires in September 2010 and contains two conditional five-year options, which if exercised would extend the lease to September 2020. Rental payments for the San Jose facility provide for increased cash payments through the lease term. Rent expense under all operating leases was approximately \$1.7 million, \$2.1 million and \$1.1 million in 2001, 2000 and 1999, respectively.

A portion of the Company's machinery and equipment is leased under agreements accounted for as capital leases. The Company had no new capital leasing arrangements during 2001 and 2000 and leased approximately \$772,000 of equipment during 1999. In 1998, the Company entered into a capital lease line of credit agreement, which allowed for combined borrowings of up to \$4.4 million to finance the acquisition of property and equipment. This agreement expired on June 30, 1999.

Future minimum lease payments under all noncancellable operating and capital lease agreements as of December 31, 2001 are as follows (in thousands):

<u>Fiscal Year</u>	<u>Operating</u>	<u>Capital</u>
2002	\$ 1,831	\$ 463
2003	1,858	241
2004	2,119	42
2005	2,186	—
2006	2,261	—
Thereafter	<u>9,183</u>	<u>—</u>
Total minimum lease payments	<u>\$ 19,438</u>	746
Less: Amounts representing interest on capital leases (4.4% to 12.0%)		<u>(31)</u>
		715
Less: Current portion		<u>(440)</u>
Long-term portion.....		<u>\$ 275</u>

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

5. PREFERRED STOCK PURCHASE RIGHTS PLAN:

In February 1999, the Company adopted a Preferred Stock Purchase Rights Plan (the "Plan") designed to enable all stockholders to realize the full value of their investment and to provide for fair and equal treatment for all stockholders in the event that an unsolicited attempt is made to acquire the Company. Under the Plan, stockholders received one right to purchase one one-thousandth of a share of a new series of preferred stock for each outstanding share of common stock held of record at the close of business on March 12, 1999 at \$150.00 per right, when someone acquires 15 percent or more of the Company's common stock or announces a tender offer which could result in such person owning 15 percent or more of the common stock. Each one one-thousandth of a share of the new preferred stock has terms designed to make it substantially the economic equivalent of one share of common stock. Prior to someone acquiring 15 percent, the rights can be redeemed for \$0.001 each by action of the board of directors. Under certain circumstances, if someone acquires 15 percent or more of the common stock, the rights permit the stockholders other than the acquirer to purchase the Company's common stock having a market value of twice the exercise price of the rights, in lieu of the preferred stock. Alternatively, when the rights become exercisable, the board of directors may authorize the issuance of one share of common stock in exchange for each right that is then exercisable. In addition, in the event of certain business combinations, the rights permit the purchase of the common stock of an acquirer at a 50 percent discount. Rights held by the acquirer will become null and void in both cases. The rights expire on February 23, 2009.

6. STOCKHOLDERS' EQUITY:

Preferred Stock

With the closing of the Company's IPO in December 1997, all of the outstanding convertible preferred stock automatically converted into common stock. Upon conversion of the outstanding preferred stock to common stock, such preferred stock was retired. The Company is authorized to issue 3,000,000 shares of new \$0.001 par value preferred stock, of which none was issued or outstanding during each of the three years ended December 31, 2001.

Common Stock

As of December 31, 2001, the Company was authorized to issue 140,000,000 shares of \$0.001 par value common stock. On October 25, 1999, the Company's Board of Directors approved a two-for-one split of the Company's common stock, in the form of a 100 percent stock dividend, which was applicable to stockholders of record at the close of business on November 8, 1999, and effective on November 22, 1999. All references to share and per-share data for all periods presented have been adjusted to give effect to this two-for-one stock split.

1988 Stock Option Plan

In June 1988, the board of directors approved the 1988 Stock Option Plan (the "1988 Plan"), whereby the board of directors may grant options to key employees, directors and consultants to purchase the Company's common stock at exercise prices of not less than 85% of the fair value of the shares at the date of grant. Options expire ten years after the date of grant (five years if the option is granted to a ten percent owner optionee) and generally vest over 50 months. Options granted under the 1988 Plan will remain outstanding in accordance with their terms, but effective July 1997, the board of directors had determined that no further options would be granted under the 1988 Plan.

1997 Stock Option Plan

In June 1997, the board of directors approved the 1997 Stock Option Plan (the "1997 Plan"), whereby the board of directors may grant options to key employees, directors and consultants to purchase the Company's common stock at exercise prices of not less than 85% of the fair value of the shares at the date of grant. The 1997 Plan allows for annual increases on the first day of the Company's fiscal year (beginning in 1999) by a number of shares equal to five percent of the number of shares of common stock issued and outstanding on the last day of

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

the preceding fiscal year. As of December 31, 2001, the 1997 Plan's maximum share reserve is 8,209,091 shares, which is comprised of the sum of (i) 5,266,127 shares (new shares allocated to the 1997 Plan) and (ii) 2,942,964 shares granted pursuant to the 1988 Plan (the "1988 Plan Options"). The number of shares available for issuance under the 1997 Plan, at any time, is reduced by the number of shares remaining subject to the 1988 Plan Options. Options expire ten years after the date of grant (five years if the option is granted to a ten percent owner optionee) and generally vest over 48 months.

1997 Outside Directors Stock Option Plan

In September 1997, the board of directors approved an Outside Director Stock Option Plan (the "Directors Plan"). A total of 800,000 shares of common stock have been reserved for issuance under the Directors Plan. The Directors Plan provides for the grant of nonstatutory stock options to nonemployee directors of the Company. The Directors Plan is designed to work automatically without administration; however, to the extent administration is necessary, it will be performed by the board of directors. The Directors Plan provides that each current and future nonemployee director of the Company will be granted an option to purchase 30,000 shares of common stock on the effective date or the date on which the optionee first becomes a nonemployee director of the Company after the effective date as the case may be (the "Initial Grant"). Thereafter, each nonemployee director who has served on the board of directors continuously for 6 months will be granted an additional option to purchase 10,000 shares of common stock (an "Annual Grant"). Subject to an optionee's continuous service with the Company, approximately 1/3rd of an Initial Grant will become exercisable one year after the date of grant and 1/36th of the Initial Grant will become exercisable monthly thereafter. Each Annual Grant will become exercisable in twelve monthly installments beginning in the 25th month after the date of grant, subject to the optionee's continuous service. The exercise price per share of all options granted under the Directors Plan will equal the fair market value of a share of common stock on the date of grant. Options granted under the Directors Plan have a term of ten years and are non-transferable. In the event of certain changes in control of the Company, options outstanding under the Directors Plan will become immediately exercisable and vested in full.

1998 Nonstatutory Stock Option Plan

In July 1998, the board of directors approved the 1998 Nonstatutory Stock Option Plan (the "1998 Plan"), whereby the board of directors may grant nonstatutory options to employees and consultants to purchase the Company's common stock at exercise prices of not less than 85% of the fair value of the shares at the date of grant. As of December 31, 2001, the maximum share reserve under this plan was 1,000,000 shares. Options expire ten years after the date of grant (five years if the option is granted to a ten percent owner optionee) and generally vest over 48 months.

The following table summarizes option activity under the Company's option plans:
(prices are weighted average prices)

	<u>Year Ended December 31,</u>					
	<u>2001</u>		<u>2000</u>		<u>1999</u>	
	<u>Shares</u>	<u>Price</u>	<u>Shares</u>	<u>Price</u>	<u>Shares</u>	<u>Price</u>
Options outstanding,						
Beginning of year	3,811,319	\$ 14.59	3,329,075	\$ 10.40	2,666,422	\$ 3.11
Granted	2,151,612	\$ 13.46	1,523,285	\$ 18.97	1,704,875	\$ 18.06
Exercised	(480,156)	\$ 7.93	(706,969)	\$ 4.22	(769,316)	\$ 2.15
Cancelled	<u>(411,050)</u>	\$ 17.88	<u>(334,072)</u>	\$ 14.78	<u>(272,906)</u>	\$ 11.23
Options outstanding,						
end of year	<u>5,071,725</u>	\$ 14.47	<u>3,811,319</u>	\$ 14.59	<u>3,329,075</u>	\$ 10.40
Exercisable, end of year.....	<u>1,747,639</u>	\$ 12.64	<u>1,072,644</u>	\$ 9.81	<u>723,496</u>	\$ 3.71

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Options issued under the 1988, 1997 and 1998 plans may be exercised at any time prior to their expiration. Options issued under the Directors Plan are exercisable upon vesting. In addition, the Company has the right, upon termination of an optionholder's employment or service with the Company, at its discretion, to repurchase any unvested shares issued under the 1988, 1997 and 1998 plans at the original purchase price. Under the terms of the option plans, an option holder may not sell shares obtained upon the exercise of an option until the option has vested as to those shares. As of December 31, 2001, there were 2,039 shares of common stock issued under the 1988, 1997 and 1998 plans that are subject to repurchase by the Company at \$14.22 per share.

The Company accounts for its Plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Had compensation expense for the Plans been determined under a fair value method consistent with SFAS No. 123, "Accounting for Stock Based Compensation," and related interpretations the Company's net income would have been decreased to the following pro forma amounts (in thousands, except per share information):

	Year Ended December 31,		
	2001	2000	1999
Net income (loss):			
As reported	6,726	19,765	24,477
Pro forma	(5,046)	9,428	18,891
Basic earnings per share:			
As reported	\$ 0.24	\$ 0.73	\$ 0.94
Pro forma	\$(0.18)	\$ 0.35	\$ 0.73
Diluted earnings per share:			
As reported	\$ 0.23	\$ 0.69	\$ 0.87
Pro forma	\$(0.17)	\$ 0.33	\$ 0.67

The weighted-average grant date fair value of options granted during fiscal years 2001, 2000 and 1999 was \$10.79, \$15.72 and \$11.85, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2001, 2000 and 1999: risk-free interest rates of 4.46, 5.77 and 5.63 percent, respectively; expected dividend yields of zero percent; expected lives of 4.0, 4.2 and 1.5 years for 2001, 2000 and 1999, respectively; expected volatility of 96%, 97% and 84% for 2001, 2000 and 1999, respectively.

The following table summarizes the stock options outstanding at December 31, 2001:

Options Outstanding				Options Exercisable		
Exercise Price	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price	
\$ 0.26—\$ 2.55	154,464	4.65	\$ 0.93	154,464	\$ 0.93	
\$ 4.00—\$ 4.38	487,071	6.44	\$ 4.33	420,591	\$ 4.32	
\$ 4.42—\$ 6.03	75,080	6.18	\$ 4.89	71,119	\$ 4.90	
\$ 6.78—\$10.25	26,525	7.53	\$ 9.72	7,760	\$ 9.15	
\$11.06—\$16.91	3,420,228	8.68	\$ 13.36	809,715	\$ 13.59	
\$17.89—\$26.38	570,163	9.02	\$ 21.58	127,066	\$ 24.12	
\$26.50—\$36.88	241,475	7.95	\$ 34.53	126,105	\$ 34.29	
\$37.50—\$44.75	90,650	7.94	\$ 42.80	25,956	\$ 41.83	
\$48.56—\$51.50	<u>6,069</u>	<u>7.86</u>	<u>\$ 50.10</u>	<u>4,863</u>	<u>\$ 49.87</u>	
\$ 0.26—\$51.50	<u>5,071,725</u>	<u>8.29</u>	<u>\$ 14.47</u>	<u>1,747,639</u>	<u>\$ 12.64</u>	

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

1997 Employee Stock Purchase Plan

Under the 1997 Employee Stock Purchase Plan (the "Purchase Plan"), 1,500,000 shares of common stock are reserved for issuance to eligible employees. The Purchase Plan permits employees to purchase common stock through payroll deductions, which may not exceed 15 percent of an employee's compensation, at 85% of the lower of the fair market value of the Company's common stock on the first or the last day of each offering period. As of December 31, 2001, 902,188 shares had been purchased and 597,812 shares were reserved for future issuance under the Purchase Plan.

Non-employee Stock Options

In 2001, 2000 and 1999, the Company granted to non-employees options to acquire 3,500, 18,700 and 3,000 shares of common stock under the 1997 Stock Option Plan, at weighted average exercise prices of \$12.10, \$11.97 and \$14.22 per share. As of December 31, 2001, 27,900 options were outstanding and 13,491 options were exercisable at exercise prices ranging from \$0.85 to \$15.06. The weighted average exercise price of the outstanding options was \$10.11, and the weighted average remaining contractual life was 9 years. In 2001, 2000 and 1999, the Company incurred consulting charges of \$187,000, \$45,000, and \$174,000. Pursuant to the provisions of SFAS No. 123, the fair value of options issued was determined based on the fair value of the consideration received, where such amount was reliably measurable, or the fair value of the equity instruments issued, in which case, the fair value was estimated as services were provided using the Black-Scholes model with the following weighted average assumptions used for grants in 2001, 2000 and 1999: risk-free interest rates of 5.20 percent to 6.80 percent; expected dividend yields of zero percent; expected lives of 10 years; and expected volatility of 90%.

Stockholder Notes Receivable

In July 1997, in connection with the purchase of common stock upon exercise of stock options granted to certain officers and employees of the Company, the Company loaned to these officers and employees an aggregate of \$405,000, at an interest rate of 6.65% pursuant to Promissory Note and Pledge Agreements. These loans, which are secured by 238,231 shares of common stock, are full recourse notes, and are due in full without regard to the value of the Company's common stock in July 2002, or at the Company's option upon (i) termination of employment with the Company, (ii) a default in the payment of any installment or principal and/or interest when due, (iii) a sale of the pledged stock or (iv) acceleration being reasonably necessary for the Company to comply with any regulations promulgated by the Board of Governors of the Federal Reserve System affecting the extension of credit in connection with the Company's securities. As of December 31, 2001, the unpaid principal portion of these loans was \$38,000.

Deferred Compensation

In connection with the issuance of stock options to employees and consultants prior to December 1997, the Company recorded deferred compensation in the aggregate amount of approximately \$566,000, representing the difference between the fair market value of the Company's common stock and the exercise price of the stock options at the date of grant. The Company amortized the deferred compensation expense over the shorter of the period in which the employee, director or consultant provides services or the applicable vesting period, which was typically over 48 months. Amortization expense was \$41,000 in 2001 and \$140,000 in each of the years ended December 31, 2000, and 1999. Compensation expense is decreased in the period of forfeiture for any accrued, but unvested compensation arising from the early termination of an option holder's services. Since recording the deferred compensation in 1997, there have been no forfeitures. The total amount of the deferred compensation was fully amortized by December 31, 2001.

Shares Reserved

As of December 31, 2001, the Company had 6,301,666 shares of common stock reserved for future issuance under Stock Option and Stock Purchase Plans.

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

7. INCOME TAXES:

The Company accounts for income taxes under SFAS No. 109 "Accounting for Income Taxes." SFAS No. 109 provides for an asset and a liability approach to accounting for income taxes under which deferred income taxes are provided based upon enacted tax laws and rates applicable to the periods in which taxes become payable.

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

	<u>Year Ended December 31,</u>		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
Current provision:			
Federal	\$ 1,949	\$10,214	\$ 7,621
State	273	393	616
Foreign	—	—	15
	<u>2,222</u>	<u>10,607</u>	<u>8,252</u>
Deferred provision (benefit):			
Federal	514	(1,759)	1,125
State	194	(377)	99
	<u>708</u>	<u>(2,136)</u>	<u>1,224</u>
Net decrease in valuation allowance	—	—	(5,142)
	<u>\$ 2,930</u>	<u>\$ 8,471</u>	<u>\$ 4,334</u>

The provision for income taxes differs from the amount, which would result by applying the applicable Federal income tax rate to income before provision for income taxes as follows:

	<u>Year Ended December 31,</u>		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
Provision computed at Federal statutory rate	35.0%	35.0%	35.0%
State tax provision, net of Federal benefit	3.1	3.1	3.1
Change in valuation allowance	—	—	(17.9)
Research and development credits	(4.5)	(2.9)	(3.4)
Foreign sales corporation	(4.7)	(4.9)	(2.5)
Non deductible expenses and other	1.4	(0.3)	0.7
	<u>30.3%</u>	<u>30.0%</u>	<u>15.0%</u>

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

	<u>December 31,</u>	
	<u>2001</u>	<u>2000</u>
Tax credit carry-forwards	\$1,588	\$1,155
Inventory reserves	1,950	2,218
Accounts receivable allowances	434	467
Accrued vacation	255	294
Other cumulative temporary differences	<u>1,119</u>	<u>1,920</u>
	<u>\$5,346</u>	<u>\$6,054</u>

Realization of the deferred tax asset is dependent on generating sufficient future taxable income. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized.

POWER INTEGRATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of December 31, 2001, the Company had research and development tax credit carryforwards of approximately \$2.2 million. These carry-forwards expire in 2021 for Federal income tax purposes. There is no expiration of research and development tax credit carryforwards for the State of California. The United States Tax Reform Act of 1986 contains provisions that limit research and development credits available to be used in any given year upon the occurrence of certain events.

8. LEGAL PROCEEDINGS:

In August 1998, the Company filed a complaint in the U.S. District Court, District of Delaware, alleging that Motorola had infringed two of the Company's circuit patents. On October 15, 1999, the jury returned a unanimous verdict in favor of the Company and determined that Motorola had willfully infringed one of the Company's patents and awarded the Company \$32.3 million in compensatory damages. In March 2000, the Company and Motorola entered into a settlement agreement, pursuant to which, the Court issued a permanent injunction prohibiting Motorola from selling the ICs that were the subject of the lawsuit. Additionally, the Company agreed not to collect the money judgment from Motorola and will continue as a preferred supplier of high-voltage power conversion ICs for cellular phone chargers that Motorola manufactures.

POWER INTEGRATIONS, INC.
SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

<u>Classification</u>	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
Allowances for doubtful accounts and customer returns:				
Year ended December 31, 1999	\$ 1,293	\$ 129	\$ (432)	\$ 990
Year ended December 31, 2000	\$ 990	\$ 1,084	\$ (1,006)	\$ 1,068
Year ended December 31, 2001	\$ 1,068	\$ 1,119	\$ (814)	\$ 1,373

POWER INTEGRATIONS, INC

**EXHIBITS
TO
FORM 10-K ANNUAL REPORT**

**For the Year Ended
December 31, 2001**

<u>EXHIBIT NUMBER</u>	<u>DESCRIPTION</u>
3.1	Restated Certificate of Incorporation. (1)
3.2	Form of Certificate of Designation, Preferences and Rights of the Terms of the Series A Preferred Stock. (2)
3.3	Certificate of Amendment to Restated Certificate of Incorporation.
3.4	By-Laws. (3)
3.5	Amendment to By-Laws. (2)
4.1	Fifth Amended and Restated Rights Agreement dated April 27, 1995, as amended, by and among us and certain of our investors. (3)
4.2	Investors' Rights Agreement dated as of May 22, 1996 between us and Hambrecht & Quist Transition Capital, LLC. (3)
10.1	Form of Indemnification Agreement for directors and officers. (3)
10.2	1988 Stock Option Plan and forms of agreements thereunder. (3)
10.3	1997 Stock Option Plan and forms of agreements thereunder. (3)
10.4	1997 Outside Directors Stock Option Plan and forms of agreements thereunder. (3)
10.5	1997 Employee Stock Purchase Plan and forms of agreements thereunder. (3)
10.6	Wafer Supply Agreement between us and OKI, dated as of October 1, 1998. (4)
10.7	Master Equipment Lease Agreement between us and Metlife Capital Limited Partnership, dated as of July 31, 1998. (4)
10.8	Loan Agreement between us and Union Bank of California, N.A., dated as of October 16, 1998. (1)
10.9	Amendment Number One, dated as of February 26, 1999, to the Wafer Supply Agreement between us and OKI, dated as of October 1, 1998. (5)
10.10	Lease agreement dated as of December 29, 1999 between us and Lincoln – RECP Hellyer OPCO, LLC, a Delaware limited liability company. (6)

10.11	Wafer Supply Agreement between us and Matsushita, dated as of June 29, 2000. (7)
10.12	Technology License Agreement between us and Matsushita, dated as of June 29, 2000. (7)
10.13	First Amendment to Loan Agreement dated October 16, 1998 between us and Union Bank of California, N.A., dated August 1, 2000. (7)
21.1	List of subsidiaries. (3)
23.1	Consent of Independent Public Accountants.
24.1	Power of Attorney (See signature page).
99.1	Letter to SEC regarding Arthur Andersen LLP representations.

-
- (1) As filed with the SEC in our annual report on Form 10-K on March 16, 1999.
 - (2) As filed with the SEC in our Current Report on Form 8-K on March 12, 1999.
 - (3) As filed with the SEC in our Registration Statement on Form S-1 on September 11, 1997.
 - (4) As filed with the SEC in our quarterly report on Form 10-Q on November 10, 1998.
 - (5) As filed with the SEC in our quarterly report on Form 10-Q on May 10, 1999
 - (6) As filed with the SEC in our annual report on Form 10-K on March 29, 2000.
 - (7) As filed with the SEC in our quarterly report on Form 10-Q on November 10, 2000.

EXHIBIT 3.3

**CERTIFICATE OF AMENDMENT TO
Restated Certificate of Incorporation**

Power Integrations, Inc., a Delaware corporation (the "Corporation"), hereby certifies:

1. That the Corporation's Board of Directors has duly adopted the following resolution:

RESOLVED, that the text of section FOURTH of the Restated Certificate of Incorporation is hereby amended to read in full as follows:

FOURTH: STOCK

The Corporation is authorized to issue two classes of stock to be designated, respectively, "Preferred Stock" and "Common Stock." The total number of shares of Preferred Stock the Corporation shall have authority to issue is 3,000,000, \$0.001 par value per share, and the total number of shares of Common Stock the Corporation shall have authority to issue is 140,000,000, \$0.001 par value per share. The shares of Preferred Stock shall initially be undesignated as to series.

The Board of Directors is hereby authorized, within the limitations and restrictions stated herein, to determine or alter the rights, preferences, privileges and restrictions granted to or imposed upon a wholly unissued series of Preferred Stock, and the number of shares constituting any such series and the designation thereof, or any of them; and to increase or decrease the number of shares constituting any such series and the designation thereof, or any of them; and to increase or decrease the number of shares of any series subsequent to the issue of shares of that series, but, in respect of decreases, not below the number of shares of such series then outstanding. In case the number of shares of any series should be so decreased, the shares constituting such decrease shall resume the status which they had prior to the adoption of the resolutions originally fixing the number of shares of such series.

2. That the proposed amendment has been duly adopted in accordance with the provisions of Section 222 and Section 242 of the General Corporation law of the State of Delaware.

The Corporation has caused this Certificate of Amendment of Restated Certificate of Incorporation to be signed by its President and Chief Executive Officer and attested to by its Secretary this 8th day of June 2000.

POWER INTEGRATIONS, INC.

By: /s/ HOWARD F. EARHART
Howard F. Earhart, President and Chief
Executive Officer

ATTEST:

/s/ ROBERT G. STAPLES
Robert G. Staples, Secretary

EXHIBIT 23.1

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our report dated January 18, 2002 included in this Form10-K into the Company's previously filed Registration Statements No. 333-42194, No. 333-56381, No. 333-69871, No. 333-83083 and No. 333-59564 on Form S-8.

/s/ ARTHUR ANDERSEN LLP

San Jose, California
March 22, 2002

EXHIBIT 99.1

[POWER INTEGRATIONS, INC. LETTERHEAD]

March 21, 2002

United States Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Ladies and Gentlemen:

This letter is to inform you that Arthur Andersen LLP (“Andersen”) has represented to us that:

The audit of the consolidated financial statements as of December 31, 2001 and for the year then ended was subject to Andersen’s quality control system for the U.S. accounting and auditing practice to provide reasonable assurance that the engagement was conducted in compliance with professional standards and that there was appropriate continuity of Andersen personnel working on the audit and availability of national office consultation. Availability of personnel at foreign affiliates of Andersen is not relevant to this audit.

Sincerely,

POWER INTEGRATIONS, INC.

By: /s/ JOHN M. COBB
John M. Cobb, Chief Financial Officer

Corporate Information

Board of Directors

Howard F. Earhart
Chairman of the Board
Power Integrations, Inc.,
Retired

Balu Balakrishnan
President and
Chief Executive Officer
Power Integrations, Inc.

Alan D. Bickell
Senior Vice President
Hewlett Packard Co., Retired

E. Floyd Kvamme
General Partner
Kleiner, Perkins, Caufield
& Byers

Nicholas E. Brathwaite
Senior Vice President and
Chief Technology Officer
Flextronics International

R. Scott Brown
Senior Vice President
Worldwide Sales
Xilinx, Inc., Retired

Steven J. Sharp
President and
Chief Executive Officer
TriQuint Semiconductors

Corporate Officers

Balu Balakrishnan
President and
Chief Executive Officer

Derek Bell
Vice President, Engineering

John M. Cobb
Chief Financial Officer
and Vice President of
Finance and Administration

Bruce Renouard
Vice President,
Worldwide Sales

Daniel M. Selleck
Vice President, Marketing

John Tomlin
Vice President, Operations

Clifford J. Walker
Vice President,
Corporate Development

Corporate Information

General Counsel
**Gray Cary Ware &
Freidenrich LLP**
Palo Alto, California
Transfer Agent
Boston Equiserve LP
Canton, Massachusetts

Independent Auditors
Arthur Anderson LLP
San Jose, California

Investor Information

To obtain our Annual Report
Form 10-K and other public
information (in pdf format),
visit our website at
www.powerint.com or by
writing to the Investor
Relations Department of
the Company.

Corporate Headquarters

**Power Integrations, Inc.
5245 Hellyer Avenue
San Jose, CA 95138
USA
+1 408 414 9200**

China

**Power Integrations
International Holdings, Inc.
Room 1705 Bao Hua Bldg.
1016 Hua Qiang Bei Lu
Shenzhen, Guangdong 518031 China
+86 755 367 5143**

Germany

**Power Integrations
International Holdings, Inc.
Neidhartrasse 25
D-86159 Augsburg
Germany
+49 821 444 2315**

India

**(Technical Support)
INNOVATECH
No. 1, (new No.42) 8th Main Road
Vasanthnagar
Bangalore, India 560052
+91 80 226 6023**

Japan

**Power Integrations, K.K.
Keuhin-Tatemono 1st Bldg.
12-20 Shin-Yokohama 2-Chrome,
Kohoku-Ku, Yokohama-Shi
Kanagawa 222, Japan
+81 45 471 1021**

Korea

**Power Integrations
International Holdings, Inc.
Room 402, Handuk Bldg.
649-4 Yeoksam-Dong,
Kangnam-Gu
Seoul, Korea
+82 2 568 7520**

Singapore

**Power Integrations Singapore
51 Goldhill Plaza #16-05
Republic of Singapore 308900
+65 6358 2160**

Taiwan

**Power Integrations
International Holdings, Inc.
17F-3, No. 510
Chung-Hsiao E. Road
Sec.5, Taipei 110 Taiwan
+886 2 2727 1221**

United Kingdom

**Power Integrations (Europe), Ltd.
Centennial Court
Easthampstead Road
Bracknell
Berkshire, RG121YQ
United Kingdom
+44 1344 462 300**