

MEMSIC Inc  
Form 10-Q  
May 15, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2009

or

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

For the transition period from            to

Commission File No. 001-33813

**MEMSIC, Inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**04-3457049**  
(I.R.S. Employer  
Identification No.)

**One Tech Drive, Suite 325**

**Andover, Massachusetts**  
(Address of principal executive offices)

**01810**  
(Zip Code)

**(978) 738-0900**  
(Registrant's telephone number, including area code)

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

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

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

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

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

The number of shares of common stock, par value \$0.00001 per share, of the registrant outstanding as of May 11, 2009 was 23,699,425.

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**MEMSIC, Inc.**

**FORM 10-Q, March 31, 2009**

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

	March 31, 2009	December 31, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 64,657,181	\$ 64,365,607
Short-term investments		1,485,023
Accounts receivable, net of allowance for doubtful accounts of \$6,441 as of March 31, 2009 and December 31, 2008	3,436,958	1,884,194
Inventories	5,549,146	6,267,911
Deferred taxes	82,841	78,204
Other assets	1,487,869	969,892
<b>Total current assets</b>	<b>75,213,995</b>	<b>75,050,831</b>
Property and equipment, net	13,688,304	13,351,721
Long-term investments	5,353,000	5,553,000
Intangible assets, net	972,513	978,256
Deferred taxes	44,704	36,439
Other assets	51,529	51,529
<b>Total assets</b>	<b>\$ 95,324,045</b>	<b>\$ 95,021,776</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,611,980	\$ 1,360,274
Accrued expenses	1,018,767	1,380,071
<b>Total current liabilities</b>	<b>2,630,747</b>	<b>2,740,345</b>
Stockholders' equity:		
Common stock, \$0.00001 par value; authorized, 100,000,000 shares; 23,699,425 and 23,694,425 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	237	237
Additional paid-in capital	96,926,233	96,538,040
Accumulated other comprehensive income	2,194,404	2,227,901
Accumulated deficit	(6,427,576)	(6,484,747)
<b>Total stockholders' equity</b>	<b>92,693,298</b>	<b>92,281,431</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 95,324,045</b>	<b>\$ 95,021,776</b>

See accompanying notes to condensed consolidated financial statements (unaudited)



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	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Net sales	\$ 6,574,666	\$ 6,258,228
Cost of goods sold	3,441,642	2,721,037
Gross profit	3,133,024	3,537,191
Operating expenses:		
Research and development	1,170,165	780,601
Sales and marketing	576,779	712,097
General and administrative	1,422,697	1,293,526
Total operating expenses	3,169,641	2,786,224
Operating income (loss)	(36,617)	750,967
Other income (expense):		
Interest and dividend income	257,865	712,519
Interest expense		(15,614)
Other, net	3,461	103,920
Total other income (expense)	261,326	800,825
Earnings before income taxes	224,709	1,551,792
Provision for income taxes	167,538	14,622
Net income	\$ 57,171	\$ 1,537,170
Net income per common share:		
Basic	\$ 0.00	\$ 0.07
Diluted	\$ 0.00	\$ 0.06
Weighted average shares outstanding used in calculating net income per common share:		
Basic	23,698,639	23,491,990
Diluted	23,842,524	23,769,511

See accompanying notes to condensed consolidated financial statements (unaudited)

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

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 57,171	\$ 1,537,170
<b>Adjustments to reconcile net income to cash provided by (used in) operating activities:</b>		
Depreciation and amortization	517,483	391,508
Stock compensation expense	336,693	338,530
Excess tax benefit from stock-based compensation arrangement		(88,721)
Deferred income taxes	(13,071)	(25,442)
<b>Changes in assets and liabilities:</b>		
Accounts receivable	(1,552,764)	667,848
Inventories	708,857	(395,885)
Other assets	(549,633)	(439,979)
Accounts payable and accrued expenses	(58,303)	(987,597)
<b>Net cash provided by (used in) operating activities</b>	<b>(553,567)</b>	<b>997,432</b>
<b>Cash flows provided by (used in) investing activities:</b>		
Purchase of short-term investments		(18,700,000)
Proceeds from sale of short-term investments	1,682,065	44,875,000
Purchase of property and equipment	(837,065)	(2,284,576)
<b>Net cash provided by investing activities</b>	<b>845,000</b>	<b>23,890,424</b>
<b>Cash flows provided by financing activities:</b>		
Proceeds from exercise of underwriter's over-allotment option to purchase common stock, net of offering costs of \$591,100		7,638,900
Proceeds from exercise of options to purchase common stock	1,500	23,649
Excess tax benefit from stock-based compensation arrangement		88,721
<b>Net cash provided by financing activities</b>	<b>1,500</b>	<b>7,751,270</b>
Effect of exchange rate changes on cash and cash equivalents	(1,359)	292,893
<b>Net increase in cash and cash equivalents</b>	<b>291,574</b>	<b>32,932,019</b>
Cash and cash equivalents beginning of period	64,365,607	20,708,794
<b>Cash and cash equivalents end of period</b>	<b>\$ 64,657,181</b>	<b>\$ 53,640,813</b>

See accompanying notes to condensed consolidated financial statements (unaudited)

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**MEMSIC, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

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

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

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

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICES**

***Principles of Consolidation***

The accompanying unaudited consolidated financial statements include the accounts of MEMSIC, Inc. and MEMSIC Semiconductor. All significant intercompany balances and transactions have been eliminated in consolidation.

***Unaudited Interim Financial Information***

The accompanying interim consolidated financial statements are unaudited. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and related notes, together with the management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, which is on file with the Securities and Exchange Commission (SEC).

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of management, the unaudited interim consolidated financial statements and notes have been prepared on the same basis as the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, and include all adjustments (consisting of normal, recurring adjustments) necessary for the fair presentation of the Company's financial position at March 31, 2009, results of operations for the three months ended March 31, 2009 and 2008 and cash flows for the three months ended March 31, 2009 and 2008. The interim periods are not necessarily indicative of results to be expected for any other interim periods or for the full year.



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

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

### ***Cash Equivalents***

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

### ***Foreign Currency***

The Company's manufacturing operations and certain other operations are conducted by MEMSIC Semiconductor. The functional currency of MEMSIC Semiconductor is the Renminbi. Financial transactions between the Company and MEMSIC Semiconductor are conducted in United States dollars. At March 31, 2009 and December 31, 2008, the underlying currency for approximately 36.6% and 38.6% of consolidated assets, respectively, was the Renminbi. The Company does not believe that it is subject to significant foreign exchange risk and, accordingly, has not utilized hedging strategies with respect to such foreign exchange exposure.

The financial statements of MEMSIC Semiconductor are translated into United States dollars in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 52, *Foreign Currency Translation*. The functional currency of MEMSIC Semiconductor, the Renminbi, is translated into United States dollars utilizing the following method: assets and liabilities are translated at the exchange rate in effect at the end of the period, and revenues and expenses are translated at the weighted average exchange rate during the year. Cumulative translation gains and losses are included as a separate component of stockholders' equity and reported as a part of comprehensive income. Transaction gains and losses are included in the consolidated statements of operations as incurred.

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

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

### ***Net Income per Common Share***

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

### ***Income Taxes***

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

### ***Inventories***

Inventories are stated at the lower of cost (weighted average FIFO) or market. The Company evaluates its inventory for potential excess and obsolete inventories based on forecasted demands and records a provision for such amounts as necessary. The Company recorded a provision of \$146,000 in the first quarter of 2009 and \$108,000 in 2008.

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***Revenue Recognition***

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

The Company sells its products to distributors as well as to end customers. Sales to distributors account for a significant amount of the Company's revenue. Sales to distributors are made pursuant to distributor agreements, which allow for the return of goods under certain circumstances. Accordingly, the Company follows the provisions of SFAS No. 48, *Revenue Recognition When Right of Return Exists*. SFAS No. 48 includes the following criteria for recognition of sales to distributors: (i) the selling price to the distributor is fixed or determinable at the date of shipment; (ii) the distributor's obligation to pay the selling price is not contingent on resale of the product; (iii) the Company's product has been shipped and risk of loss has passed to the distributor; (iv) it is probable that the amount due from the distributor will be collected; (v) the Company does not have significant future obligations to directly assist in the distributor's resale of the product; and (vi) the amount of future returns can be reasonably estimated. Once these criteria are met, the Company recognizes revenue upon shipment to the distributor and estimates returns based on historical sales returns.

During the first quarter of 2008, the Company recorded \$2.0 million in revenue from the sale of printed circuit boards for use in the Olympic torch project that was reversed in the second quarter of 2008.

***Stock-Based Compensation***

The Company accounts for share-based payments to employees in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)). SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The cost of equity-based service awards is based on the grant-date fair value of the award and is recognized over the period during which the employee is required to provide service in exchange for the award (vesting period). Stock-based compensation arrangements with non-employees are accounted for utilizing the fair value method or, if a more reliable measurement, the value of the services or consideration received. The resulting compensation expense is recognized for financial reporting over the term of performance or vesting.

***Recent Accounting Pronouncements***

In April 2008, the FASB issued FASB Staff Position (FSP) 142-3, *Determination of the Useful Life of Intangible Assets*, which amends the factors that must be considered in developing renewal or extension assumptions used to determine the useful life over which to amortize the cost of a recognized intangible asset under SFAS No. 142. The FSP is effective for financial statements for fiscal years beginning after December 15, 2008. SFAS No. 142 was effective for the Company on January 1, 2009. The adoption of the provisions of SFAS No. 142 did not have any impact on the Company's financial position and results of operations.

In December 2007, the FASB issued SFAS 141R, *Business Combinations* (SFAS 141R). This statement is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. For the Company, this statement is effective prospectively for business combinations for which the acquisition date is on or after January 1, 2009. The adoption of the provisions of SFAS 141R did not have any impact on the Company's financial position and results of operations.

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In December 2007, the FASB released a proposed FASB Staff Position (FSP SFAS 157-2 Effective Date of FASB Statement No. 157) which, if adopted, would delay the effective date of SFAS No. 157 until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for all non-financial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157-2 was effective for the Company on January 1, 2009. The adoption of the provisions of SFAS 157-2 did not have any impact on the Company's financial position and results of operations.

### **3. LONG-TERM INVESTMENTS**

Investments held by the Company at March 31, 2009 consisted primarily of auction rate securities, or ARS, and are considered available for sale. These securities reset the interest or dividend rates by auctions held at intervals of 7, 28, 35 or 49 days, and at such dates the Company has the option to sell such securities. The auction rate securities held by the Company have contractual maturities of greater than 10 years.

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

At March 31, 2009, the Company held two ARS investments: Illinois Educational Facilities Authority Select Auction Variable Rate Securities having a value at par of \$3.0 million and Montana Health Facility Authority Select Auction Variable Rate Securities having a value at par of \$2.6 million. The Company has classified these investments as long-term assets due to liquidity issues that have recently been experienced in global credit and capital markets as well as failed auctions since the first quarter of 2008. A failed auction means that the amount of securities submitted for sale at auction exceeded the amount of purchase orders. If an auction fails, the issuer becomes obligated to pay interest at penalty rates, and all of the auction rate securities the Company holds continue to pay interest in accordance with their stated terms. However, the failed auctions create uncertainty as to the liquidity of these securities.

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

#### ***Fair Value Measurement***

The Company accounts for assets and liabilities recognized or disclosed in the financial statements at fair value on a recurring basis in accordance with the provisions of SFAS No. 157, *Fair Value Measurements* (SFAS No. 157).

SFAS No. 157 provides that fair value is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants based on the highest and best use of the asset or liability. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. SFAS No. 157 requires the Company to use valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized as follows:

- Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets
- Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs

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

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

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

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

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

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

	Carrying amount as of March 31, 2009	Level 1	Level 2	Level 3	Valuation Technique
Auction rate securities	\$ 5,353	\$	\$	\$ 5,353	(B)

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

	Auction Rate Securities
Balance at January 1, 2009	\$ 5,553
Redemptions	(200)
Transfers to Level 3	
<i>Gains and losses:</i>	
Reported in earnings	
Reported in other comprehensive loss	
Balance at March 31, 2009	\$ 5,353

The Company historically accounted for the ARS held in its portfolio as available-for-sale investments. The carrying value of these ARS approximated fair value due to the frequent resetting of the interest rate. While the Company continues to earn interest at the specified contractual rate on those investments involved in failed auctions, due to the failed auctions and the illiquidity of these securities under current market conditions, the Company has considered whether par value continues to be a reasonable basis for estimating the fair value of these ARS at March 31, 2009. The Company estimated the fair value of these securities at March 31, 2009 using broker valuations and internally-developed models of the expected future cash flows related to the securities as well as referencing a third party specialist's valuation. One of the more significant assumptions made in the Company's internally-developed models was the term of expected cash flows of the underlying auction rate securities and the discount related to the illiquidity of the investments. The Company developed several scenarios for the liquidation of the auction rate securities over periods that ranged from 3 to 7 years. In estimating the fair value of these investments, the Company considered the financial condition and near-term prospects of the issuers, the magnitude of the losses compared to the investments' cost, the length of time the investments have been in an unrealized loss position, the low probability that the Company will be unable to collect all amounts due according to the contractual terms of the security, whether the security has been downgraded by a rating agency, and the Company's ability and intent to hold these investments until the anticipated recovery in market value occurs. Based on the estimated operating cash flows and other sources of cash, the Company intends to hold these auction rate securities for the foreseeable future, if necessary.



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The Company's valuation analysis in the first quarter of 2009 resulted in no change in the unrealized impairment loss recorded at December 31, 2008. The Company continues to monitor the market for auction rate securities and to assess its impact on the fair value of the Company's investments. If current market conditions deteriorate further, the Company may be required to record additional temporary unrealized losses in other comprehensive income (loss) or, if the decline in fair value is judged to be other-than-temporary, the cost basis of the individual security may be written off to fair value as a new cost basis and the amount of the write-down would be reflected as a charge to earnings.

**4. INVENTORIES**

Inventories consist of the following:

	March 31, 2009	December 31, 2008
Raw materials	\$ 1,306,880	\$ 1,575,554
Work in process	3,389,309	3,397,176
Finished goods	852,957	1,295,181
Total	\$ 5,549,146	\$ 6,267,911

**5. STOCK BASED COMPENSATION***Description of Plan*

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

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

*Valuation of Stock Options*

The Company uses the Black-Scholes option pricing model to calculate the grant-date fair value of an option award. The weighted-average fair values per share of the options granted during the three months ended March 31, 2009 and 2008 were \$1.72 and \$4.41, respectively, utilizing the following assumptions:

	Three Months Ended March 31,	
	2009	2008
Volatility	77%	64%
Expected dividend yield	0%	0%

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Expected life	5 years	5 years
Risk free interest rate	1.6% - 1.9%	2.5% - 3.3%
Forfeitures	28% - 46%	22%

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As there was no public market for the Company's common stock prior to the Company's IPO in December 2007, and limited historical information on the volatility of its common stock since the date of the Company's IPO, the Company determined the volatility for options granted in the three months ended March 31, 2009 and 2008 based on an analysis of reported data for a peer group of companies that issued options with substantially similar terms. The expected volatility of options granted has been determined using an average of the historical volatility measures of this peer group of companies for a period equal to the expected life of the option. The Company has not paid and does not anticipate paying cash dividends on its shares of common stock; therefore, the expected dividend yield is assumed to be zero. The expected life of options has been determined utilizing the simplified method as prescribed by the SEC's Staff Accounting Bulletin No. 107, *Share-Based Payment*. The risk-free interest rate is based on a zero coupon United States treasury instrument whose term is consistent with the expected life of the stock options. The Company applies an estimated forfeiture rate, based on its historical forfeiture experience, in determining the expense recorded in the Company's consolidated statement of operations.

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

	Options Outstanding	Weighted Average Exercise Price	Remaining Contractual Term in Years	Aggregate Intrinsic Value
Options outstanding at December 31, 2008	2,357,055	\$ 5.26	8.5	\$ 461,764
Granted	78,000	1.72		
Exercised	(5,000)	0.30		
Cancelled	(245,837)	4.00		
Options outstanding at March 31, 2009	2,184,218	\$ 5.28	8.3	\$ 480,879
Options exercisable at March 31, 2009	548,968	\$ 3.49	6.5	\$ 392,063
Options available for grant at March 31, 2009	667,950			

For the three months ended March 31, 2009 and 2008, the Company recorded stock-based compensation expense of \$336,693 and \$338,530, respectively. At March 31, 2009, total unrecognized stock-based compensation expense expected to be charged to operations over the next four years is estimated to approximate \$4.1 million.

The intrinsic values (aggregate market value of the underlying common stock minus aggregate exercise price) of stock options exercised during the three months ended March 31, 2009 and 2008 were \$8,500 and \$250,275, respectively. The total fair value of options that became exercisable during the three months ended March 31, 2009 and 2008 were approximately \$123,000 and \$191,000, respectively.

Stock-based compensation expense related to stock options for the three months ended March 31, 2009 and 2008 was allocated as follows:

	Three Months Ended March 31,	
	2009	2008
Research and development	\$ 74,274	\$ 63,913
Sales and marketing	57,596	47,986
General and administrative	204,823	226,631
Total	\$ 336,693	\$ 338,530





**Table of Contents****6. COMPREHENSIVE INCOME**

SFAS No. 130, *Reporting Comprehensive Income*, establishes standards for reporting and displaying comprehensive income and its components in financial statements. Comprehensive income is defined to include all changes in stockholders' equity during the period other than those changes that result from investments by and distributions to stockholders. For the three months ended March 31, 2009 and 2008, the Company's comprehensive income is the sum of net income and the foreign currency translation adjustment, as follows:

	<b>For the Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Net income	\$ 57,171	\$ 1,537,170
<i>Other comprehensive income (loss):</i>		
Foreign currency translation adjustment	(33,497)	770,323
Total comprehensive income	\$ 23,674	\$ 2,307,493

**7. COMMON STOCK**

In December 2007, the Company completed its initial public offering (IPO) of 6,000,000 shares of its common stock at a price to the public of \$10.00 per share. The Company raised a total of \$52.6 million in net proceeds after deducting underwriting discounts and offering expenses. Upon the closing of the offering, all shares of the Company's redeemable convertible preferred stock automatically converted into 14,060,818 shares of common stock. The holders of the Company's common stock are entitled to one vote for each share held.

In January 2008, the underwriters of the Company's initial public offering exercised their over-allotment option to purchase 823,000 shares. The Company received net proceeds of \$7.6 million from this exercise, after deducting underwriting discounts and offering expenses. At March 31, 2009, the outstanding shares of the Company's common stock are 23,699,425 shares. The Company has reserved 2,852,168 shares for the issuance of common stock upon exercise of stock options outstanding and available to grant under its stock option plans.

**8. NET INCOME PER COMMON SHARE**

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

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Numerator:</b>		
Net income	\$ 57,171	\$ 1,537,170
<b>Denominator:</b>		
Basic weighted average shares	23,698,639	23,491,990
Dilutive effect of common stock equivalents	143,885	277,521
Diluted weighted average shares	23,842,524	23,769,511

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During the three months ended March 31, 2009 and 2008, the Company had 1.7 million and 0.9 million dilutive potential common shares in the form of stock options, which were not included in the computation of net income per diluted share because these stock options would be anti-dilutive.

**9. SEGMENT INFORMATION**

The Company conducts its operations and manages its business in one segment, the development and design, manufacture and sale of semiconductor sensor systems solutions based on micro-electromechanical systems (MEMS) technology and advanced integrated circuit design. Within this segment, the Company's chief executive officer views the operations of the manufacturing unit and the sales and marketing organizations as an integrated business unit and utilizes enterprise wide operating results as the only factor in making operating decisions.

Revenues by geographical region are as follows:

	<b>Three months ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Asia (excluding Japan)	\$ 4,602,970	\$ 3,439,511*
Europe	422,037	388,197
Japan	294,311	898,176
North America	1,255,348	1,529,101
Other		3,243
<b>Total</b>	<b>\$ 6,574,666</b>	<b>\$ 6,258,228</b>

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\* Includes \$2.0 million torch related revenue that was recorded in the first quarter of 2008 and reversed in the second quarter of 2008

Revenues by product application are as follows:

	<b>Three months ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Mobile Phone	\$ 3,578,810	\$ 1,008,525
Consumer	1,319,787	3,417,110*
Automotive	1,328,984	1,445,275
Industrial/other	347,085	387,318
<b>Total</b>	<b>\$ 6,574,666</b>	<b>\$ 6,258,228</b>

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\* Includes \$2.0 million torch related revenue that was recorded in the first quarter of 2008 and reversed in the second quarter of 2008

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Total assets by geographical region are as follows:

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
United States	\$ 60,443,389	\$ 58,369,649
China	34,880,656	36,652,127
<b>Total</b>	<b>\$ 95,324,045</b>	<b>\$ 95,021,776</b>

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

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

**OVERVIEW**

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

We have experienced significant growth since our products were first commercialized in 2001 primarily in the sales of our products for mobile phone applications and automotive applications. Although our growth in 2008 was adversely affected by the slowdown in the mobile handset market in China, the May 2008 earthquake in China and generally weak global economic conditions, our revenue grew in the first quarter of 2009 as a result of strong demand for our accelerometers in the mobile phone market in China.

The outlook for the balance of 2009 is uncertain. The U.S. and other global economies are currently experiencing a recession that has affected all sectors of the economy and that has continued to deepen, resulting in declines in economic growth and consumer confidence, increases in unemployment rates and uncertainty about economic stability. Global credit and financial markets have also experienced extreme disruptions, including diminished liquidity and credit availability and rapid fluctuations in market valuations. Our business has been affected by these conditions and is likely to be affected by them in the future, and there is no certainty that economic conditions will not deteriorate further. These uncertainties affect businesses such as ours in a number of ways, making it difficult to accurately forecast and plan our future business activities. Deteriorating economic conditions may lead consumers and businesses to continue to postpone spending, which may cause our customers to cancel, decrease or delay their existing and future orders with us. In addition, the inability of customers to obtain credit could negatively affect our revenues and our ability to collect receivables. In addition, financial difficulties experienced by our suppliers or distributors could result in product delays, increased accounts receivable defaults and inventory challenges.

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We expect that sales of our accelerometer products to continue to represent a predominant share of our revenue for the foreseeable future. We expect that sales of our first non-accelerometer products, including magnetic sensors and gas-flow sensors will begin to increase in the second half of 2009.

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

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

We manufacture our products utilizing a semi-fabless model by outsourcing the production of CMOS wafers and completing the post-CMOS MEMS process in-house. By outsourcing the standard CMOS manufacturing process, we are able to more efficiently manage our capital expenditures and cost of goods sold.

### **Description of Certain Line Items**

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

Net sales represent gross revenue net of an allowance for the estimated amount of product returns and sales rebates from our customers. Sales to distributors are made pursuant to distributor agreements, which allow for the return of goods under certain circumstances. We recognize revenue in accordance with Staff Accounting Bulletin No. 104 and Statement of Financial Accounting Standards No. 48, or SFAS 48. While we sell our products to distributors as well as end customers, sales to distributors account for a significant amount of the total revenue.

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

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

we may also reduce our product prices as we are able to increase our production yields or to reduce our manufacturing costs;

changes in our product mix may affect the average selling prices of our products. For example, our products for consumer and mobile phone markets generally have lower average selling prices than products for the automotive market. The average selling

prices of products may also be affected by our strategy to increase market adoption of our products in certain markets; and

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

**Net Sales by Application**

In the first quarter of 2009, net sales from mobile phone applications were the largest component of our total sales, representing 54.4% of total net sales. We expect that net sales from mobile phone applications will continue to be the largest component of our total sales in 2009.

Net sales from automotive applications, in absolute terms, decreased in the first quarter of 2009, primarily due to the current global downturn in the automotive market. To increase net sales from the automotive market, we are currently seeking to increase sales from new automotive applications and to expand our customer base. However, revenue increases, if any, from the automotive market will require significant time, as the development lead time in this market is generally longer than other markets to date, and this market has been disproportionately affected by the current global downturn.

Net sales from consumer applications have fluctuated historically as a result of the generally short life cycle of consumer electronics and changes in our customer base. As our product offering and customer base for consumer applications continue to diversify, we expect net sales from consumer applications to fluctuate less. Net sales from industrial and other markets have been limited, and we do not expect revenue from these markets to contribute significantly to our total revenue in 2009.

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

	<b>Three months ended March 31,</b>			
	<b>2009</b>		<b>2008</b>	
	<b>Amount</b>	<b>% of Sales</b>	<b>Amount</b>	<b>% of Sales</b>
Mobile Phone	\$ 3,579	54.4%	\$ 1,009	16.1%
Consumer	1,320	20.1	3,417*	54.6
Automotive	1,329	20.2	1,445	23.1
Industrial/other	347	5.3	387	6.2
<b>Total</b>	<b>\$ 6,575</b>	<b>100.0%</b>	<b>\$ 6,258</b>	<b>100.0%</b>

\* Includes \$2.0 million torch related revenue that was recorded in the first quarter of 2008 and reversed in the second quarter of 2008

**Net Sales by Customer Base**

Our customers primarily consist of distributors, OEMs and ODMs. Historically, a small number of our customers have accounted for a substantial portion of our net sales. We expect that significant customer concentration will continue for the foreseeable future. Our customers representing 10% or more of our net sales accounted for approximately 78.8% and 71.6%, respectively, of our net sales in 2008 and 2007.

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

Occasionally, design changes in the products of our OEM and ODM customers have resulted in the loss of sales. For example, a design change in a product of a large OEM customer in 2007 for mobile phone applications resulted in a decrease of our sales to such customer in 2008. That customer accounted for 44.6% of our net sales in 2007.



**Table of Contents****Net Sales by Geography**

Our products are shipped to OEM and ODM customers worldwide. However, we focus on different application markets among geographical regions. In the greater China region, our revenue has historically been primarily derived from products for mobile phone applications. We are also seeking to expand the consumer and industrial applications markets in the greater China region. In Japan, our revenue has primarily been derived from products for consumer applications, particularly projectors. We are also seeking to penetrate the automotive market in Japan. In North America, our revenue has primarily been derived from products for automotive applications. In Europe, our revenue has fluctuated. In 2008, we experienced a revenue increase from products for automotive applications in Europe.

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

	Three months ended March 31,			
	2009		2008	
	Amount	% of Sales	Amount	% of Sales
Asia (excluding Japan)	\$ 4,603	70.0%	\$ 3,440*	55.0%
Europe	422	6.4	388	6.2
Japan	294	4.5	898	14.4
North America	1,256	19.1	1,529	24.3
Other			3	0.1
Total	\$ 6,575	100.0%	\$ 6,258	100.0%

\* Includes \$2.0 million torch related revenue that was recorded in the first quarter of 2008 and reversed in the second quarter of 2008

**Cost of Goods Sold**

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

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

**Gross Profit and Gross Margin**

Our gross margin has decreased from 65.1% in 2007, to 47.9% in 2008 and 47.7% in the first three months of 2009. Our gross profit and gross margin are affected by a variety of factors, including average selling prices of our products, our product application mix, prices of wafers, excess and obsolete inventory, pricing by competitors, changes in production yields, and percentage of sales conducted through distributors. Our products for mobile phone applications, which are sold to distributor customers, have historically had lower margins than our products for automotive products, which are sold directly to our OEM and ODM customers, and this trend has accelerated recently. The increase in the percentage of our net sales in products for mobile phone applications in recent years has therefore had an adverse effect on our overall gross margin. Notwithstanding the relatively lower margin in the mobile phone applications market, we expect to derive an increasing percentage of our total net sales from that market because of the significant potential for further revenue growth from increased penetration in that market.

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

Research and development expenses are recognized as they are incurred and primarily consist of salaries and wages of research and development employees; research costs, primarily consisting of mask costs and prototype wafers, consulting fees paid for outside design services; travel and other expenses; and beginning in 2006, stock-based compensation under SFAS 123(R) attributable to our research and development employees.

Historically, research and development expenses have increased both in absolute terms and as a percentage of total net sales. We expect this trend to continue for the foreseeable future as we seek to diversify into non-accelerometer products and hire additional employees.

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

Sales and marketing expenses primarily consist of wages, salaries and commissions for our sales and marketing personnel; consulting expenses, primarily consisting of sales consulting services and software application consulting services; travel expenses; independent sales representatives commissions; office rental; market promotion and other expenses and stock-based compensation under SFAS 123(R). While we expect the sales and marketing expense to increase in the long term as we continue to invest in sales and marketing resources to develop new market applications, expand our sales marketing network and engage in additional marketing and promotional activities, we expect such expenses to decrease in both absolute terms and as a percentage of total net sales in 2009 as a result of sales and marketing headcount reduction at the end of 2008.

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

General and administrative expenses primarily consist of salaries and wages for administrative personnel; costs for professional services, including legal, tax and accounting services; depreciation and amortization expenses for non-manufacturing equipment; travel and entertainment expenses; office supply and other office-related expenses; office rental expenses; other expenses, such as utilities, insurance and provision for accounts receivable; and stock-based compensation under SFAS 123(R). We expect that our general and administrative expenses for 2009 in absolute terms will be consistent with 2008 levels. However, we expect that such expenses will decrease as a percentage of net sales.

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

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

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

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

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

In the United States, we are subject to the federal income tax and the Massachusetts state income tax, which are approximately at the rates of 34% and 9.5%, respectively. At December 31, 2008, the Company had gross U.S. net operating loss carryforwards of \$1.4 million, which expire in the year 2028. Included within this amount is approximately \$258,000 of excess tax deductions associated with non-qualified stock options that have been exercised. When these excess tax benefits actually result in a reduction to currently payable income taxes, the tax benefit will be recorded as an increase to additional paid-in capital. At December 31, 2008, we established a full valuation allowance against the U.S. deferred tax assets since we are in a three-year cumulative loss position in the United States. Our operating losses may be subject to limitations under provisions of the Internal Revenue Code.

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



**Table of Contents***PRC tax*

Our PRC taxes primarily consist of enterprise income tax, value-added tax, and certain other miscellaneous taxes. As of December 31, 2008, our Wuxi subsidiary had no PRC NOL carryforwards available to offset future PRC enterprise income tax. Beginning in 2009, our Wuxi subsidiary entered into a three-year period at a 50% reduced income tax rate.

*Enterprise Income Tax*

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

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

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

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

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

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

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

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

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

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



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

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

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

See Risk Factors Risks Related to Doing Business in China The discontinuation of any of the preferential tax treatments currently available to us in China could materially and adversely affect our business, financial condition and results of operations.

### *Other PRC taxes*

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

## **Critical Accounting Policies and Estimates**

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

We consider an accounting policy to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the consolidated financial statements. For a discussion of the critical accounting policies that we consider to be the most sensitive and that require the most significant estimates and assumptions used in the preparation of our consolidated financial statements, see our Annual Report on Form 10-K for the year ended December 31, 2008, under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies. There has been no change in our critical accounting policies and estimates from those described in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Table of Contents****RESULTS OF OPERATIONS**

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

	For the Three Months Ended March 31,			
	Amount	% of net sales	Amount	% of net sales
	(dollar amounts in thousands)			
Net sales	\$ 6,575	100.0%	\$ 6,258	100.0%
Cost of goods sold	3,442	52.3	2,721	43.5
Gross profit	3,133	47.7	3,537	56.5
Operating expenses:				
Research and development	1,170	17.8	781	12.5
Sales and marketing	577	8.8	712	11.4
General and administrative	1,423	21.6	1,293	20.6
Total operating expenses	3,170	48.2	2,786	44.5
Operating income (loss)	(37)	(0.5)	751	12.0
Other income (expense):				
Interest and dividend income	258	3.9	713	11.4
Interest expense			(16)	(0.2)
Other, net	4	0.1	104	1.7
Total other income (expense)	262	4.0	801	12.9
Earnings before income taxes	225	3.5	1,552	24.9
Provision for income taxes	168	2.5	15	0.2
Net income	\$ 57	1.0%	\$ 1,537	24.7%

**Quarter Ended March 31, 2009 Compared to Quarter Ended March 31, 2008**

**Net sales.** Our net sales increased by 5.1% to \$6.6 million for the three months ended March 31, 2009 from \$6.3 million in the corresponding period of 2008. This increase was primarily attributable to the increase in mobile phone sales in China as a result of the China economic stimulus plan and the increase in the accelerometer adoption rate in the mobile phone market. Net sales in the first quarter of 2008 included \$2.0 million revenue related to the Olympic torch project that was reversed in the second quarter of 2008. Sales in mobile phone applications accounted for \$3.6 million in net sales in the three months ended March 31, 2009, compared to \$1.0 million in the corresponding period for 2008. Sales in automotive applications experienced a slight decrease, accounting for \$1.3 million for the three months ended March 31, 2009, compared to \$1.4 million in the corresponding period in 2008.

**Cost of goods sold.** Our cost of goods sold increased by 26.5% to \$3.4 million for the three months ended March 31, 2009 from \$2.7 million for the corresponding period in 2008. This increase was primarily due to the increase in the volume of units sold.

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**Gross profit and gross margin.** Our gross profit decreased by 11.4% to \$3.1 million for the three months ended March 31, 2009 from \$3.5 million in the corresponding period of 2008. Our gross margin decreased by 8.8% to 47.7% for the three months ended March 31, 2009 from 56.5% in the corresponding period of 2008. This decrease was attributable to a continued decline in the average selling prices of our products in the mobile phone market due to competitive pressures. Our gross margin for the first quarter of 2008 would have been 63.8% if the \$2.0 million of revenue and \$1.2 million of cost of sales associated with the Olympic torch project had been excluded from our results for the quarter.

**Research and development.** Our research and development increased by 49.8% to \$1.2 million for the three months ended March 31, 2009 from \$0.7 million in the corresponding period of 2008. This increase was primarily due to the increase in the research costs related in developing new products and system solutions in this period as compared to the corresponding period of 2008. Research and development expenses, as a percentage of total net sales, increased to 17.8% for the three months ended March 31, 2009 from 12.5% for the corresponding period of 2008.

**Sales and marketing.** Our sales and marketing expenses decreased by 19.0% to \$577,000 for the three months ended March 31, 2009 from \$712,000 for the corresponding period of 2008. The decrease was primarily due to headcount reduction in our sales and marketing department at the end of 2008 as a result of expense control initiatives taken in the fourth quarter of 2008. Sales and marketing expenses, as a percentage of total net sales, decreased to 8.8% for the three months ended March 31, 2009 from 11.4% for the corresponding period of 2008.

**General and administrative.** Our general and administrative expenses increased by 10.1% to \$1.4 million for the three months ended March 31, 2009 from \$1.3 million in the corresponding period of 2008. This increase was primarily due to an increase in professional fees. General and administrative expenses, as a percentage of total net sales, increased to 21.6% for the three months ended March 31, 2009 from 20.6% for the corresponding period in 2008.

**Other income.** Our other income was \$0.3 million for the three months ended March 31, 2009 compared to \$0.8 million in the corresponding period of 2008. The decrease was primarily due to a decrease in interest income as a result of a decrease in interest rates.

**Provision for income taxes.** Our income tax provision was \$168,000 for the three months ended March 31, 2009 compared to an income tax provision of \$15,000 in the corresponding period of 2008. Our income tax provision for the first quarter of 2009 reflected principally income tax expense of \$168,000 recorded by our Wuxi subsidiary, related to earnings in China, at the effective rate of 12.5%. Beginning in 2009, our Wuxi subsidiary started its three-year tax holiday period at one-half the unified tax rate of 25%, which will extend until 2011 at which time the rate will increase to 25%.

**LIQUIDITY AND CAPITAL RESOURCES**

As of March 31, 2009, our principal sources of liquidity consisted of cash and cash equivalents of \$64.7 million. Our principal uses of cash historically have consisted of payments to our suppliers for the costs related to the outsourcing of wafer fabrication and outsourced processing fees paid to and materials purchased from third parties, as well as payments for our manufacturing overhead and equipment purchases. Other significant cash outlays primarily consist of salaries, wages and commissions for our non-manufacturing related employees.

As of March 31, 2009, our investments included \$5.3 million (net of \$247,000 impairment loss) of auction rate securities. Auction rate securities are generally long-term fixed income instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined calendar intervals, typically every 7, 28, 35 or 49 days. Due to liquidity issues that have recently been experienced in global credit and capital markets, certain of the auction rate securities we hold have failed at auction, meaning that the amount of securities submitted for sale at auction exceeded the amount of purchase orders. If an auction fails, the issuer becomes obligated to pay interest at penalty rates, and all of the auction rate securities we hold continue to pay interest in accordance with their stated terms. However, the failed auctions create uncertainty as to the liquidity in the near term of these securities. As a result, we have classified the \$5.3 million of auction rate securities we held at March 31, 2009 as long-term investments.



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

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

### ***Operating Activities***

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

### ***Investing Activities***

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

### ***Financing Activities***

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

### ***Off-Balance Sheet Arrangements***

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

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**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest rate risk.* Currently, our exposure to interest rate risk primarily relates to the interest income generated by excess cash invested in deposits as well as short-term securities. We have not historically used and do not expect to use in the future any derivative financial instruments to manage our interest risk exposure. Interest-earning instruments carry a degree of interest rate risk. We have not been exposed nor do we anticipate being exposed to material risks due to changes in interest rates.

*Foreign exchange risk.* The value of the RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. The conversion of RMB into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under this new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant fluctuation of the RMB against the U.S. dollar. Although all of our revenue and a significant portion of our payments are denominated in U.S. dollars, a large portion of our payments are denominated in RMB. Fluctuations in exchange rates, primarily those involving the U.S. dollar, may affect our costs and operating margins as well as our net income reported in U.S. dollars. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency exchange risk.

*Market risk; auction rate securities.* As of March 31, 2009, our investments included \$5.3 million of auction rate securities. We have classified these securities as long-term investments and at December 31, 2008 recorded an unrealized temporary loss of \$247,000 in other comprehensive income. We have determined that no further other-than-temporary impairment in the value of these securities existed as of March 31, 2009. If the credit and capital markets deteriorate further, the credit ratings of the issuers or the insurers of the auction rate securities are downgraded or the collateral underlying the securities deteriorates or other events occur that would affect the fair value of these auction rate securities, we might conclude that some or all of them have sustained an other-than-temporary impairment in value, such that we would be required under GAAP to write down their carrying value. Any such write-down would result in a charge against our earnings in the period in which the impairment is recognized, which could be material.

**Item 4. Controls and Procedures****A. Evaluation of Disclosure Controls and Procedures**

Based on the evaluation of our disclosure controls and procedures (as defined in the Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) required by Exchange Act Rules 13a-15(b) or 15d-15(b), our Chief Executive Officer and our Principal Financial and Accounting Officer have concluded that as of March 31, 2008, the end of the period covered by this report, our disclosure controls and procedures were effective.

**B. Changes in Internal Controls**

There were no changes in our internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f), that occurred during the fiscal quarter ended March 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are a party to various legal proceedings incidental to our business. However, we have no legal proceedings currently pending that are expected to be material to our operations or financial presentation.

**Item 1A. Risk Factors**

There has been no material change in the risk factors disclosed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

The net proceeds to us of our initial public offering, after deducting underwriting discounts and offering expenses, were approximately \$60.2 million. Through March 31, 2009, we have applied approximately \$2.2 million of the net proceeds to fund capital expenditures for the expansion of our manufacturing facility in Wuxi and \$5.0 million to the construction of two new buildings adjacent to that facility. We have invested the balance of \$53.0 million of the net proceeds from our initial public offering in money market funds and auction rate securities, pending other uses.

We repurchased no shares of our common stock during the three months ended March 31, 2009.

**Table of Contents****Item 6. Exhibits**

Exhibit No.	Description	Filed with This Form 10-K	Incorporated by Reference		Exhibit No.
			Form	Filing Date	
3.1	Second Amended and Restated Certificate of Incorporation of MEMSIC, Inc.		8-K	December 19, 2007	3.1
3.2	Amended and Restated By-Laws of MEMSIC, Inc.		S-1/A	November 30, 2007	3.4
4.1	Form of common stock certificate.		S-1/A	December 7, 2007	4.2
4.2	Fifth Amended and Restated Investor Rights Agreement.		S-1	September 28, 2007	4.3
31.1	Chief Executive Officer certification required by Rule 13a-14(a)	X			
31.2	Principal Accounting Officer certification required by Rule 13a-14(a)	X			
32.1	Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350	X			
32.2	Principal Financial and Accounting Officer certification pursuant to 18 U.S.C. Section 1350	X			

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**SIGNATURES**

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

**MEMSIC, Inc.**

**Dated: May 15, 2009**

**By: /S/ YANG ZHAO  
Yang Zhao  
Chief Executive Officer and President  
Principal Executive Officer**

**Dated: May 15, 2009**

**By: /S/ PATRICIA NIU  
Patricia Niu  
Principal Financial and Accounting Officer**