

2018 Annual Report



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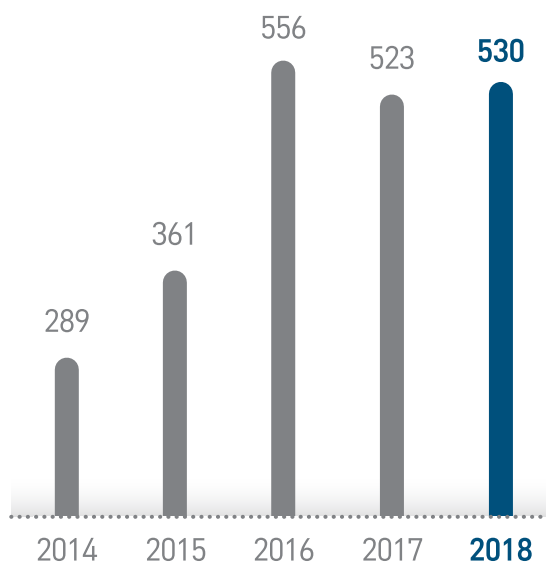
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Financial Highlights

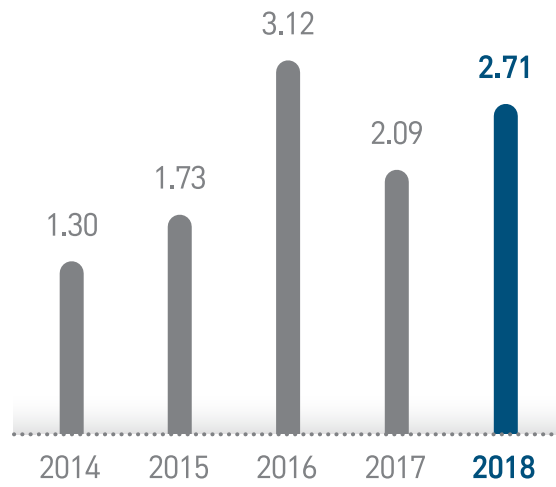
Market Segments (% of Net Sales)



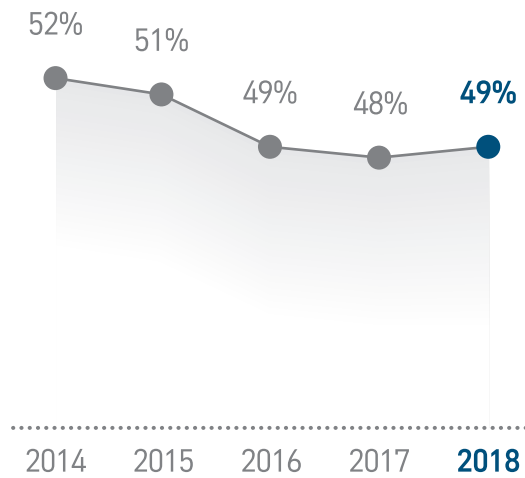
Net Sales (US\$ millions)



Diluted Earnings per ADS (US\$)



Gross Margin (% of Net Sales)



Letter to Shareholders

Dear Shareholders,

In 2018, we delivered \$530 million of sales, 1% higher than in the prior year. Sales of our SSD controllers grew strongly while sales of our eMMC+UFS controllers declined. Earnings per ADS grew 21% to \$3.41 from \$2.81 in 2017*.

The NAND flash industry transitioned rapidly from extreme supply shortages in 2017 to over-supply conditions in 2018. Supply shortages in 2017 affected the availability of NAND components for SSDs and other solid-state storage solutions, and additionally, resultant higher NAND prices impacted the unit growth of the storage device market. By the first quarter of 2018 however, NAND components were becoming widely available as industry supply increased and prices were softening. By the third quarter, NAND prices had returned to 2016 levels, and with lower NAND prices, SSDs were becoming increasingly affordable and our SSD controller sales benefited from this positive trend.

Key 2018 business milestones include:

- SSD controller sales increased about 30% year-over-year
- eMMC+UFS controller sales decreased about 10% year-over-year
- SSD solutions sales decreased about 5% year-over-year
- Began sampling Open-Channel NVMe SSD controller for data centers with a second hyperscaler
- Began shipping our SSD controllers to two US NAND flash makers for world's first two QLC-based PCIe NVME client SSDs
- Began shipping our SSD controllers to a US NAND flash partner for one of the world's first 96-layer TLC-based SSD

In 2018, our SSD controller sales grew about 30% and accounted for almost 40% of our total revenue. With NAND industry supply increasing faster than demand during the year, NAND prices fell and this in turn led to improving SSD affordability and growing demand for controllers. With NAND prices expected to continue falling in 2019 and strong interest by OEMs to use more SSDs in PCs and other client devices, we believe it is likely our SSD controller sales will continue to grow next year.

Our eMMC+UFS controller sales declined about 10% this year and represented 25% to 30% of our total revenue. Our sales were affected by several factors: a slowdown in global smartphone sales, our primary eMMC customer reducing its exposure to the mobile market and this customer continuing their transition from older eMMC using our controllers to newer UFS products that use their own controllers. We expect these unfavorable trends to continue in 2019, with sequential trends to become more favorable in the second half of the year as our China module maker eMMC programs and NAND flash customer's UFS projects scale further.

SSD solutions sales remain roughly 20% of total sales but had declined about 5% for the year as sales of both our customized Shannon data center SSDs and Ferri industrial SSDs declined. Our mature Shannon Direct-IO SSDs are reaching end-of-life and commercial deployment of our new Open Channel SSDs was delayed to mid-2019 due to extended R&D work. Separately, our Ferri SSD sales revenue was affected by lower NAND prices. We expect declining SSD solutions sales to continue in 2019.

We remain optimistic about our long-term growth. We are the clear merchant leader in supplying SSD controllers for client devices and believe growth for these products will continue for many more years as more than half of all client devices selling annually remains to transition from HDDs to SSDs. Furthermore, we are preparing to enter the enterprise SSD controller market to deliver longer-term growth. Sales of both our eMMC+UFS controllers and SSD solutions are expected to decline further in 2019, but we believe sales of both products should reach trough levels by mid-2019 and are well positioned for a rebound the following year. In anticipation of stronger future sales, earnings and cash flow, in the fourth quarter of 2018, our Board authorized a \$200 million two-year share repurchase program.

Finally, I would like to thank our customers for their business, our employees for their hard work and dedication and our shareholders for their support over the years.

Sincerely,



James Chow
Chairman of the Board



Wallace C. Kou
President and Chief Executive Officer

* Please refer to our 6-K disclosures for a reconciliation of GAAP to Non-GAAP earnings.

About Silicon Motion

Silicon Motion Technology Corporation is the global leader in developing NAND flash controllers for SSDs and other solid state storage devices. We have over 20 years of experience developing specialized processor ICs that manage NAND components and deliver market leading, high-performance storage solutions widely used in smartphones, PCs, data centers and commercial and industrial applications. We have one of the broadest portfolios of controller intellectual properties developed from our deep understanding of NAND characteristics, which enables us to design both unique, highly optimized configurable IC plus related firmware controller platforms and complete turnkey controller solutions. In the last ten years, we have shipped over six billion controllers, more than any other company in the world. More NAND flash components, including current and up-coming generations of 3D flash produced by Intel, Micron, Samsung, SK Hynix, Toshiba and Western Digital, are supported by Silicon Motion controllers than any other company. Our customers include NAND flash makers, storage device module makers, hyperscalers and OEMs.

We are the world's leading merchant supplier of SSD controllers used in PCs and other client devices and leading merchant supplier of eMMC + UFS controllers used in smartphones and IoT devices.

We also leverage our controller expertise to supply customized high-capacity specialty SSD solutions for the Chinese hyperscale data center market and small single-chip form factor SSDs for high-performance industrial, commercial and automotive applications.

We market our controllers under the "SMI" brand, enterprise-grade SSDs under the "Shannon Systems" brand and single-chip industrial-grade SSDs under the "Ferri SSD" and "Ferri-eMMC" brands. We were founded in 1995 in San Jose, California and now operate from corporate offices in Hong Kong, Taiwan and the US.

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 20-F

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
 ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
 SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report: N/A
For the transition period from _____ to _____
Commission file number: 000-51380

Silicon Motion Technology Corporation

(Exact name of Registrant as specified in its charter)

Cayman Islands
(Jurisdiction of incorporation or organization)
Unit 04-05, 27/F, #909 Cheung Sha Wan Rd.
Cheung Sha Wan, Kowloon
Hong Kong
Tel: +852 2307 4768
Fax: + 852 2307 4368
(Address of principal executive offices)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Ordinary shares, par value US\$0.01 per share* American Depositary Shares, each representing four ordinary shares	SIMO	Nasdaq Global Select Market

* Not for trading, but only in connection with the listing on the Nasdaq Global Select Market of American Depositary Shares, or ADSs, each representing four ordinary shares.

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

None

Securities registered or to be registered pursuant to Section 15(d) of the Act:

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 144,679,404 ordinary shares as of December 31, 2018, US\$0.01 par value per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Emerging growth company	<input type="checkbox"/>

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards[†] provided pursuant to Section 13(a) of the Exchange Act.

[†] The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012. Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP	<input checked="" type="checkbox"/>	International Financial Reporting Standards as issued by the International Accounting Standards Board	<input type="checkbox"/>	Other	<input type="checkbox"/>
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If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act): Yes No

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CONVENTIONS THAT APPLY TO THIS ANNUAL REPORT

Unless otherwise indicated, references in this annual report to:

- “ADRs” are to the American depositary receipts that evidence our ADSs;
- “ADSs” are to our American depositary shares, each of which represents four of our ordinary shares;
- “CAGR” are to compound annual growth rate;
- “China” or “PRC” are to the People’s Republic of China, excluding the special administrative regions of Hong Kong and Macau;
- “Korea” are to the Republic of Korea, or South Korea;
- “Korea Won” are to the legal currency of South Korea;
- “Nasdaq” are to the Nasdaq Stock Market;
- “NT dollar,” “NT dollars” or “NT\$” are to New Taiwan dollars, the legal currency of Taiwan;
- “ROC” or “Taiwan” are to the Republic of China, the official name of Taiwan;
- “shares” or “ordinary shares” are to our ordinary shares, with a par value US\$0.01 per share;
- “U.S. GAAP” are to generally accepted accounting principles in the United States;
- “U.S. dollar,” “U.S. dollars” or “US\$” are to United States dollars, the legal currency of the United States; and
- “we,” “us,” “our company,” “our,” “SMTC” and “Silicon Motion” are to Silicon Motion Technology Corporation, its predecessor entities and subsidiaries including but not limited to (i) Silicon Motion Technology (HK) Ltd., incorporated in Hong Kong, (ii) Silicon Motion, Inc., incorporated in Taiwan, or SMI Taiwan, and formerly known as Feiya Technology Corporation, (iii) Silicon Motion, Inc., a California, USA, corporation, or SMI USA, (iv) FCI Inc., incorporated in Korea, or FCI, and (v) Shanghai Baocun Information Technology Co., Ltd., incorporated in the PRC, or Shannon Systems.

Silicon Motion, the Silicon Motion logo, FCI, the FCI logo, the Shannon Systems logo, PCIe-RAID, DIRECT-IO, Hyper-IO, airRF, basicRF, ezRF, ezSYS, powerRF, twinRF, zipRF, zipSYS, VirtualZero, SSDLifeGuard, SSDLifeSaver, TurboMLC, FerriSSD, Ferri-eMMC, Bigtera, the Bigtera logo, and NANDXtend are our trademarks or registered trademarks. We may also refer to trademarks of other corporations and organizations in this document.

Unless otherwise indicated, our financial information presented in this annual report has been prepared in accordance with U.S. GAAP.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements. These forward-looking statements include statements regarding our financial position; our expectations concerning future operations, margins, profitability, liquidity and capital resources; our business strategy and other plans and objectives for future operations; and all other statements that are not historical facts. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “intends,” “plans,” “anticipates,” “believes,” “thinks,” “estimates,” “seeks,” “predicts,” “potential,” and similar expressions. Although we believe that these statements are based on reasonable assumptions, they are subject to numerous factors, risks and uncertainties that could cause actual outcomes and results to be materially different from those projected. These factors, risks and uncertainties include those listed under “Risk Factors” and elsewhere in this annual report. Those factors, among others, could cause our actual results and performance to differ materially from the results and performance projected in, or implied by, the forward-looking statements. They include:

- unpredictable volume and timing of customer orders, which are not fixed by contract but vary on a purchase order basis;
- the loss of one or more key customers or the significant reduction, postponement, rescheduling or cancellation of orders from these customers;
- general economic conditions or conditions in the semiconductor or consumer electronics market;
- decreases in the overall average selling prices of our products;
- changes in the relative sales mix of our products;
- the payment, or non-payment, of cash dividends in the future at the discretion of our board of directors;
- changes in our cost of finished goods;
- the effects on our business and our customer’s business taking into account the ongoing US-China tariffs and trade disputes;
- the effects, if any, on the price of our ADSs as a result of the announcement and implementation of our previously announced share repurchase program;
- the availability, pricing and timeliness of delivery of other components and raw materials used in our and our customers’ products;
- our customers’ financial health, sales outlook, purchasing patterns and inventory adjustments based on consumer demand, market adoption of new technologies and general economic conditions;
- our ability to successfully develop, introduce and sell innovative, new or enhanced products in a timely manner; and
- the timing of new product announcements or introductions by us or by our competitors.

One or more of these factors could materially and adversely affect our operating results and financial condition in future periods. We cannot assure you that we will attain any meaningful estimates or maintain profitability or that the assumptions on which they are based are reliable.

Except as required by law, we undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this annual report. All forward-looking statements contained in this annual report are qualified by reference to this cautionary statement. As you read and consider this annual report, you should carefully understand that the forward-looking statements are not guarantees of performance or results.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Consolidated Financial Data

You should read the following information with our consolidated financial statements and related notes and “Item 5. Operating and Financial Review and Prospects” included elsewhere in this annual report.

The selected consolidated statements of income and cash flow data for the years ended December 31, 2016, 2017 and 2018 and the selected consolidated balance sheet data as of December 31, 2017 and 2018 are derived from our audited consolidated financial statements included elsewhere in this annual report and should be read in conjunction with, and are qualified in their entirety by reference to, these consolidated financial statements and related notes. The selected consolidated statements of income for the years ended December 31, 2014 and 2015 and the selected consolidated balance sheet data as of December 31, 2014, 2015 and 2016 are derived from our audited consolidated financial statements which are not included in this annual report. To reflect our early adoption of the new accounting update on the statement of cash flows, we retrospectively adjusted the selected consolidated statements of cash flow data for the years ended December 31, 2014 and 2015, which are not derived from our audited consolidated financial statements included in our prior annual reports. These consolidated financial statements are prepared in accordance with U.S. GAAP.

	Year Ended December 31,				
	2014	2015	2016	2017	2018
	US\$	US\$	US\$	US\$	US\$
	(in thousands, except for per share data)				
Consolidated Statements of Income Data:					
Net sales	289,323	361,297	556,146	523,404	530,348
Cost of sales	139,625	176,765	281,541	272,210	269,541
Gross profit	149,698	184,532	274,605	251,194	260,807
Operating expenses:					
Research and development	60,949	71,161	92,405	102,053	102,028
Sales and marketing	16,324	20,173	25,765	25,868	29,279
General and administrative	13,355	15,714	17,072	16,933	17,633
Impairment of goodwill and intangible assets	—	—	—	10,337	4,069
Amortization of intangible assets	—	1,051	2,103	2,534	2,964
Gain from disposal of noncurrent assets held for sale	—	—	—	(1,880)	—
Total operating expenses	90,628	108,099	137,345	155,845	155,973
Operating income	59,070	76,433	137,260	95,349	104,834
Total non-operating income	1,498	2,067	1,370	3,652	5,027
Income before income taxes	60,568	78,500	138,630	99,001	109,861
Income tax expense	16,101	18,249	27,690	24,046	11,791
Net income	44,467	60,251	110,940	74,955	98,070
Weighted average shares outstanding:					
Basic	134,604	138,100	140,919	142,738	144,123
Diluted	136,787	139,634	142,050	143,606	144,512
Earnings per share:					
Basic	0.33	0.44	0.79	0.53	0.68
Diluted	0.33	0.43	0.78	0.52	0.68
Earnings per ADS ⁽¹⁾ :					
Basic	1.32	1.75	3.15	2.10	2.72
Diluted	1.30	1.73	3.12	2.09	2.71

(1) Each ADS represents four ordinary shares.

	As of December 31,				
	2014	2015	2016	2017	2018
	US\$	US\$	US\$	US\$	US\$
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	194,211	180,519	274,483	359,453	284,989
Other current assets	96,229	134,657	202,417	209,344	213,501
Working capital	234,374	226,889	330,914	391,553	384,839
Long-term investments	133	133	120	—	4,242
Property and equipment, net	35,537	50,469	47,892	51,370	101,410
Goodwill and intangible assets, net	35,467	75,990	73,883	66,393	59,352
Other non-current assets	4,957	3,860	7,231	7,172	9,120
Total assets	366,534	445,628	606,026	693,732	672,614
Total liabilities	62,434	101,130	163,263	199,681	140,337
Total shareholders' equity	304,100	344,498	442,763	494,051	532,277

	As of December 31,				
	2014	2015	2016	2017	2018
	As Adjusted US\$	As Adjusted US\$	US\$	US\$	US\$
	(in thousands)				
Consolidated Cash Flow Data:					
Net cash provided by operating activities	68,725	65,946	125,568	103,881	108,242
Net cash used in investing activities ⁽¹⁾	(11,596)	(58,458)	(8,220)	(14,548)	(79,568)
Net cash provided by (used in) financing activities	(19,710)	(20,271)	2,194	(31,740)	(101,820)
Depreciation and amortization	6,917	8,987	11,585	13,133	14,796
Capital expenditures	(11,596)	(23,664)	(12,220)	(11,683)	(74,853)

(1) The selected consolidated statements of cash flow data for the years ended December 31, 2014 and 2015 were retrospectively adjusted to reflect the Company's election to early adopt the accounting update of the classification and presentation of changes in restricted cash on the statement of cash flows. See Note 2 to our audited consolidated financial statement included in this annual report for more information.

Risk Factors

Because our operating results for any period could be adversely affected by a number of factors, some of which are outside of our control, and may therefore fluctuate significantly, our annual and quarterly operating results are difficult to predict.

Our operating results have fluctuated in the past and could do so in the future. For example, our net income decreased \$36.0 million from 2016 to 2017 and increased \$23.1 million from 2017 to 2018. Fluctuations in our operating results may be due to a number of factors, including, but not limited to, those listed below and those identified throughout this "Risk Factors" section:

- competitive pressures and other factors such as the qualification, availability and pricing of competing products and technologies and the resulting effects on sales and pricing of our products;
- changes in demand for electronic devices into which our semiconductor solutions are directly or indirectly incorporated;
- our customers' sales outlook, purchasing patterns and inventory adjustments based on market demand, adoption of new technologies and general economic conditions;

- the loss of one or more key customers or the significant reduction, timing or cancellation of orders from these customers;
- seasonality or cyclical fluctuations in our markets;
- our ability to develop or acquire, introduce, market and transition to volume production new or enhanced products and technologies in a cost-effective and timely manner;
- changes in supply and availability of flash memory components used in our and our customer's products;
- changes in our product mix or customer mix and their effect on our gross margin;
- changes in foreign currency exchange rates;
- the availability and pricing of third party semiconductor foundry services;
- unpredictable volume and timing of customer orders, which are not fixed by contract but vary on an order-to-order basis;
- deferrals or reductions of customer orders in anticipation of new products or product enhancements from us or our competitors or other providers of integrated circuits;
- our ability to timely and accurately predict market requirements and evolving industry trends and to identify and capitalize upon opportunities in new markets; and
- the overall cyclical nature of, and changing economic and market conditions in, the semiconductor industry.

These and other factors make it difficult for us to assess our future performance. Our sales and operating results are difficult to predict and have in the past, and will likely in the future, fluctuate from period to period. We could fail to achieve the operating targets that we have announced, such as revenue growth, gross margin, and operating expense. In addition, our operating results in the future may be below the expectations of securities analysts or investors, which would likely cause the market price of our ADSs to decline. Any variations in our period-to-period performance may also cause the market price of our ADSs to fluctuate. Accordingly, you should not rely on the results of any prior periods as a reliable indicator of our future operating performance.

Our operating results and stock price may be adversely affected by worldwide economic uncertainties including political and social instability and industry-specific conditions in the markets we operate.

Disruptions or uncertainties in the economy, including any political and social instability may lead consumers and business to postpone spending. This in turn may cause our customers to cancel, decrease or delay their existing and future orders with us. Furthermore, we operate primarily in the semiconductor industry, which is cyclical in nature and subject to evolving industry standards. In the past, the semiconductor industry had experienced significant downturns characterized by decreases in product demand, excess customer inventories and accelerated erosion of prices. The semiconductor industry also periodically experiences increased demand and production capacity constraints, which may affect our ability to deliver products to our customers. Economic volatility can cause extreme difficulties for our customers and vendors in accurately forecasting and planning future business activities. The uncertain effects and resolution of the US-China tariff dispute is an example of political uncertainty. This unpredictability could cause our customers to reduce spending on our products and services, which would delay and lengthen sales cycles. The accurate forecasting and planning for our operations heavily rely on these worldwide economic and industry-specific conditions, and the volatility and uncertainties associated with these factors may adversely affect our results of operation in a material manner.

Since we have limited visibility as to the sales volume by our customers of devices using our products, our ability to accurately forecast future demand for and sales of our products is limited.

The majority of our products are integrated into devices that are sold directly or indirectly into markets which are difficult for us and our customers to accurately forecast as computing and mobile devices demand is subject to significant seasonality, with higher net sales generally in the second half of each year, when our customers place orders to meet increased demand during year-end holiday seasons, and other fluctuations. Also, as a significant portion of our quarterly sales are from orders received and fulfilled in that quarter, our visibility as to expected orders from our customers in subsequent periods and for any extended period of time is limited. Additionally, we depend upon our customers' procurement forecasts in order to forecast demand for our products, and our customers' procurement forecast may be subject to change. Our failure to accurately forecast demand for our products may result in lost sales or excess inventory and associated reserves or write-downs for our operations. Any of the aforementioned factors could affect sales of our products and thereby harm our business, financial condition and operating results.

If demand for our products declines in the major end-markets that we serve, our sales, net revenue and earnings will decrease.

Demand for our products is affected by a number of factors, including the general demand for the products in the end-markets that we serve and price attractiveness of the devices incorporating our products that our customers and vendors offer to end-markets. A significant amount of our sales revenue is derived from customers who use our controllers in expandable and embedded solid state storage solutions used in computing and mobile devices. Any significant decrease in the demand for these devices in the end-market may decrease the demand for our semiconductor solutions and may result in a significant decrease in our revenues and earnings. Computing and mobile devices that use our components rapidly change as product capabilities are upgraded or new classes of products are introduced, and these changes may result in a significant reduction in demand for our products. We cannot give any assurance that there will not be any downturn in the future or that any future downturn will not affect our results of operations. Any significant decrease in demand for end-user applications of semiconductors will negatively affect our sales, net revenue and earnings.

We may pursue acquisitions, investments and dispositions, which could adversely affect our results of operations.

Our growth strategy includes the acquisition of, and investment in, businesses that offer complementary products, services and technologies, augment our market coverage, or enhance our technological capabilities. Our recent acquisitions include Shannon Systems in 2015 and Bigtera in 2017. Our recent investments include DeepVision and ProGrade in 2018. We may not be able to identify suitable acquisition or investment opportunities, or to consummate any such transactions. In addition, our original estimates and assumptions used in assessing any transaction may be inaccurate and we may not realize the expected financial or strategic benefits of any such transaction.

Any acquisitions we may undertake involve risks and uncertainties, such as unexpected delays, challenges and related expenses, and diversion of management's attention. We may become subject to legal proceedings relating to the acquisition and the integration of acquired businesses may not be successful. The integration of an acquired business involves significant challenges, including, among others: potential disruption of our business, diversion of management's attention from daily operations and the pursuit of other opportunities; incurring significant restructuring charges and amortization expense, assuming liabilities and ongoing lawsuits, potential impairment of acquired goodwill and other intangible assets, and increasing our expenses and working capital requirements; and implementing our management information systems, operating systems and internal controls for the acquired operations. In addition, our due diligence process may fail to identify significant issues with the acquired company's products, financial disclosures, accounting practices, legal, tax and other contingencies and compliance with local laws and regulations. These difficulties may be complicated by factors such as the size of

the business or entity acquired, geographic and cultural differences, lack of experience operating in the industry or geographic markets of the acquired business, potential loss of key employees and customers, the potential for deficiencies in internal controls at the acquired or combined business, performance problems with the acquired business' technology, exposure to unanticipated liabilities of the acquired business, insufficient revenue to offset increased expenses associated with the acquisition, adverse tax consequences and our potential inability to achieve the growth prospects or synergies expected from any such acquisition.

Failure to manage and successfully integrate the acquisitions we make, or to improve sales and margins of the acquired businesses, could materially harm our business, operating results and margins.

Any future acquisitions we make may require debt or equity financing, which, in the case of debt financing, would increase our leverage and interest expenses, and in the case of equity financing, would be dilutive to our existing stockholders. Acquisitions made in cash would reduce our cash reserves.

From time to time, we may also seek to divest or wind down portions of our business, either acquired or otherwise, or we may exit minority investments, each of which could materially affect our cash flows and results of operations. In March 2019, we announced that we had entered into an agreement to sell FCI to Dialog Semiconductor. Any future dispositions we may make could involve risks and uncertainties, including our ability to sell such businesses on terms acceptable to us, or at all. In addition, any such dispositions could result in disruption to other parts of our business, potential loss of employees or customers, or exposure to unanticipated liabilities or ongoing obligations to us following any such dispositions. For example, in connection with such dispositions, we may enter into transition services agreements or agree to provide certain indemnities to the purchaser, which may result in additional expenses and may adversely affect our financial condition and results of operations. See "Item 8. Recent Developments".

We depend on a small number of customers for a significant portion of our revenues and a loss of some of these customers would result in the loss of a significant portion of our revenues.

We derived a substantial portion of our revenue from sales to a relatively small number of customers. As a result, the loss of any significant customer could materially and adversely affect our financial condition and results of operations. Sales to our five largest customers represented approximately 58%, 57% and 54% of our net revenue in 2016, 2017 and 2018, respectively. Sales to two customers in 2017 and 2018, and one customer in 2016 accounted for 10% or more of our net revenue, representing 28%, 39% and 34% of our net revenue in 2016, 2017 and 2018, respectively. In 2017 and 2018, the significant customers were SK Hynix and Intel and in 2016, SK Hynix. The identities of our largest customers and their respective contributions to our net revenue have varied and will likely continue to vary from period to period.

We expect that we will continue to depend on a relatively limited number of customers for a substantial portion of our net sales and our ability to maintain good relationships with these customers will be important to the ongoing success of our business. We cannot assure you that the revenue generated from these customers, individually or in the aggregate, will reach or exceed historical levels in any future period. Our failure to meet the demands of these customers could lead to a cancellation or reduction of business from these customers. In addition, loss, cancellation or reduction of business from, significant changes in scheduled deliveries to, or decreases in the prices of products sold to any of these customers could significantly reduce our revenues and adversely affect our financial condition and operating results. Moreover, any difficulty in collecting outstanding amounts due from our customers particularly customers who place large orders, would harm our financial performance. In addition, if our relationships with our largest customers are disrupted for any reason, it could have a significant impact on our business.

NAND industry cyclicality could adversely affect our growth and profitability.

The NAND industry is highly capital intensive and regularly experiences cycles of shortages and excess supply and related rapid increases and sharp decreases in NAND component prices. The price of solid state

storage devices, such as SSDs and eMMC and UFS devices, in which NAND accounts for a significant portion of material cost, could also rise and fall with NAND component prices. Falling prices for solid state storage devices could trigger stronger market demand for these devices as well as controllers used in them, and conversely, rising prices for solid state storage devices could cause demand for these devices as well as controller used in them to fall, which could negatively affect our sales and profitability.

Additionally, during periods of NAND shortage, our sales and profitability could be negatively affected in many other ways, including: (i) our non-NAND vendor storage customers and we may not be able to procure sufficient supplies of NAND components for our Shannon data center SSDs and Ferri industrial SSDs, which could lead to reduced sales of our SSD solutions, and furthermore, to higher cost of procured NAND components and reduced SSD solutions profitability; (ii) NAND manufacturers may divert NAND supply away from module maker customers who are our controller customers towards their own internal consumption, which could lead to reduced procurement of our controllers; and (iii) NAND manufacturers may divert NAND supply away from products using our controllers towards products not using our controllers and our sales could be reduced.

During periods of NAND excess supply when NAND prices are falling sharply, our sales and profitability could also be negatively affected in additional ways, including: (i) NAND manufacturers facing reduced demand for NAND components and storage devices may temporarily build NAND inventory instead of selling at lower prices, and this may cause a reduction in controller demand; (ii) module maker customers that are exposed to volatile NAND pricing conditions may temporarily become more cautious in procuring NAND components, which could lead to reduced levels of controller procurement and storage device production; (iii) OEMs may temporarily limit procurement of storage devices in expectation of procuring more at a later date and at a lower price, which could restrain storage device and controller procurement; and (iv) NAND vendor and module maker customers that are under margin pressure because of falling NAND prices may seek price concessions from their controller suppliers.

If we fail to accurately anticipate and respond to market trends or fail to develop and introduce new or enhanced products to address these trends on a timely basis, our ability to attract and retain customers could be impaired and our competitive position could be harmed.

We operate in industries characterized by rapidly changing technologies and industry standards as well as technological obsolescence, and our products have short life cycles. NAND manufacturers introduce new generations of technology at regular cycles of every one to two years, and every generation of technology, such as high-layer count 3D NAND and multi-level cell, results in increasing lower cost NAND memory components with worse data retention and endurance characteristics that require management by more sophisticated controller solutions. Over the last decade, rapid reductions in NAND component cost have led to a growing proliferation of new applications, from smartphones to PCs and data centers, which use SSDs and other types of solid state storage devices that are dependent on controllers for delivering required storage performance, such as for PCI Express, in terms of data rate, latency and other features. We believe that our future success depends on our ability to develop and introduce new technologies and products for new applications to generate new sources of revenue to replace, or build upon, existing product revenue streams for applications that are mature or in secular decline. If we are not able to repeatedly introduce, in successive years, new products for new applications that ship in volume, our revenue will likely not grow and may decline significantly and rapidly.

In addition, we may not have sufficient management resources to manage, R&D capabilities to address, and financial resources to fund all of the required research to develop future innovations and meet changing industry standards. Moreover, even if we have adequate management resources, R&D capabilities, and financial resources, our future innovations may be outpaced by competing innovations. As a result, we may lose customers and significant sales, and our business and operating results may be materially and adversely affected.

The average selling prices of our controller ICs have historically decreased and will likely do so in the future, which could harm our revenue and profitability.

The controller ICs we develop and sell, especially those for expandable and embedded storage solutions, are used for high volume applications and have historically decreased over time, and we believe that it is possible they may also fall in the future. We may experience period-to-period fluctuations in future operating results if our average selling prices decline. We may be forced to reduce the average unit price of our products in response to new product introductions by our competitors, competitive pricing pressures and other factors. The mobile and computing devices markets are extremely cost sensitive, which may result in rapidly declining average selling prices of electronic devices and components, such as those made by us, used in devices and create downward pressure on our average selling prices and operating results. To maintain acceptable operating results, we will need to develop and introduce new products and product enhancements on a timely basis and continue to reduce our costs. If we are unable to offset any reductions in our average selling prices by increasing our sales volumes or reducing corresponding production costs or if we fail to develop and introduce new products and enhancements on a timely basis, our sales and operating results will be materially and adversely affected.

A failure to accurately forecast our future sales may adversely affect our results of operations and harm our business.

We have limited sales visibility as our customers typically do not provide us with firm, long-term purchase commitments. Additionally, our customers may also have limited sales visibility because of the rapidly changing nature of the global economy, NAND supply and demand dynamics and the markets in which devices using our products are sold. Substantially all of our sales are made on a purchase order basis, which permits our customers to cancel, change or delay their product purchase commitments with little or no notice to us and often without penalty to them, which limits our ability to accurately forecast sales and maintain adequate inventory levels, manufacturing capacity and operating infrastructure requirements.

To ensure the availability of our products for our customers, in some cases we cause our manufacturers to begin manufacturing our products based on forecasts provided by these customers in advance of receiving purchase orders. However, these forecasts do not represent binding purchase commitments, and we do not recognize revenue from these products until they are shipped to the customer. As a result, we incur inventory and manufacturing costs in advance of anticipated revenue. Because demand for our products may not materialize, manufacturing based on forecasts subjects us to risks of high inventory carrying costs and increased obsolescence and may increase our costs. If we overestimate customer demand for our products or if purchase orders are cancelled or shipments delayed, we may end up with excess inventory that we cannot sell, which could have a material and adverse effect on our financial results. Conversely, if we underestimate demand, we may not have sufficient product inventory and may lose market share and damage customer relationships, which could also harm our business.

Because many of our expenses are fixed in the short term or are incurred in advance of anticipated sales, we may not be able to decrease our expenses in a timely manner to offset any shortfall of sales, or expand our R&D and other operating infrastructure in a timely manner to capture anticipated business opportunities. If we expand our business operations and demand for our products does not increase as we may have projected, our operating results could be affected by our higher operating expense levels. Conversely, if we maintain or reduce our business operations and related expenses in accordance with our projections and demand for our products increases more than expected, our operating results could be affected by lost business opportunity, less competitive economies of scale, and damaged relationships with our customers.

The loss of any of our key personnel or the failure to attract or retain specialized technical and management personnel could impair our ability to grow our business.

We rely heavily on the services of our key employees, including Wallace C. Kou, our President and Chief Executive Officer. In addition, our engineers and other key technical personnel are a significant asset and are the

source of our technological and product innovations. We believe our future success will depend upon our ability to retain these key employees and our ability to attract and retain other skilled managerial, engineering, technical and sales and marketing personnel. The competition for such personnel, particularly technical personnel, is intense in our industry. We may not be successful in attracting and retaining sufficient numbers of technical personnel to support our anticipated growth. These technical personnel are required to design and develop integrated circuits, including firmware, and to introduce product enhancements for use in future applications. Despite the incentives we provide, our current employees may not continue to work for us, and if additional personnel were required for our operations, we may not be able to obtain the services of additional personnel necessary for our growth. In addition, we do not maintain “key person” life insurance for any of our senior managers or other key employees. The loss of any of our key employees or our inability to attract or retain qualified personnel, including engineers, could delay the development and introduction of, and have an adverse effect on our ability to sell, our products as well as have an adverse effect on our overall growth. In addition, if any other members of our senior management or any of our other key personnel join a competitor or form a competing company, we may not be able to replace them easily and we may lose customers, business partners, key professionals and staff members. Substantially all of our senior executives and key personnel have entered into confidentiality and non-disclosure agreements. In the event of a dispute between any of our senior executives or key personnel and our operating companies in Taiwan, China or Korea, we cannot assure you the extent, if any, to which these provisions may be enforceable in Taiwan, China, or Korea due to the constantly evolving nature of the Taiwanese, Chinese, and Korean legal systems.

We may not be able to deliver our products on a timely basis if our relationships with our suppliers, our semiconductor foundries or our assembly and test subcontractors are disrupted or terminated.

We do not own or operate semiconductor fabrication facilities. Instead, we rely on third parties to manufacture our semiconductors. Two outside foundries, Taiwan Semiconductor Manufacturing Company (“TSMC”) and Semiconductor Manufacturing International Corporation (“SMIC”), with fabs in Taiwan, Singapore, and China currently manufacture the majority of our semiconductors. As a result, we face several significant risks, including higher wafer prices, availability of wafers and other raw materials, lack of manufacturing capacity, quality assurance, manufacturing yields and production costs, limited control over delivery schedules and product quality, increased exposure to potential misappropriation of our intellectual property, labor shortages or strikes and actions taken by third party contractors that breach our agreements.

The ability of each foundry to provide us with semiconductors is limited by its available capacity and access to wafers. We do not have long-term agreements with any of these foundries and we place orders on a purchase order basis. We place our orders based on our customers’ purchase orders and sales forecasts. However, the foundries can allocate capacity to the production of the products of their other customers and reduce deliveries to us on short notice or increase the price they charge us. It is possible that other foundry customers that are larger and better financed than we are, or have long-term agreements with these foundries, may induce these foundries to reallocate capacity to them. Any reallocation could impair our ability to secure manufacturing capacity that we need for our products. In addition, interruptions to the wafer manufacturing processes caused by a natural disaster or human error could result in partial or complete disruption in supply until manufacturing is re-started or we are able to shift manufacturing to another fabrication facility. It may not be possible to obtain sufficient capacity or comparable production costs at another foundry. Migrating our design methodology to a new third-party foundry could involve increased costs, resources and development time comparable to a new product development effort. Any reduction in the supply of semiconductors for our products could significantly delay our ability to ship our products and potentially have negative effects on our relationships with existing customers and our results of operations. In addition, if our subcontractors terminate their relationships with us, we would be required to qualify new subcontractors, which could take at least six months, resulting in unforeseen operating problems, and our operating results may be materially and adversely affected.

If the foundries that provide us with the products for our operations do not achieve satisfactory yield or quality, or if the assembly and testing services fail us in the quality of their output, then our revenue, operating results and customer relationships will be affected.

The manufacture of semiconductors is a highly complex process. Minor deviations in the manufacturing process can cause substantial decreases in yield. In some situations, such deviations may cause production to be suspended. The foundries that manufacture our semiconductors have from time to time experienced lower than anticipated manufacturing yields, including yields for our semiconductors, typically during the production of new products or architectures or during the installation and start-up and ramp-up of new process technologies or equipment. If the foundries that manufacture our semiconductors do not achieve planned yields, our product costs could increase and product availability would decrease.

After the wafer fabrication processes, our wafers are shipped to our assembly and testing subcontractors. We have a system to maximize consistent product quality, reliability and yield that involves our quality assurance team working closely with subcontractors in the various phases of the assembly and testing processes. Our supplier quality management includes procedures such as processes to pre-qualify our manufacturing suppliers and subcontractors. However, despite our efforts to strengthen supplier quality management, if our foundries fail to deliver fabricated silicon wafers of satisfactory quality in the volume and at the price we require, or if our assembly and testing subcontractors fail to efficiently and accurately assemble and test our products, we will be unable to meet our customers' demand for our products or to sell those products at an acceptable profit margin, which would have a material and adverse effect on our sales and margins and damage our customer relationships.

Failure to protect our proprietary technologies or maintain the right to certain technologies may negatively affect our ability to compete.

We believe that the protection of our intellectual property rights is and will continue to be important to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into confidentiality or license agreements with our employees, business partners and other third parties, and have implemented procedures to control access to and distribution of our documentation and other proprietary information. Despite these efforts, we cannot assure you that these measures will provide meaningful protection of our intellectual property rights. Further, these agreements do not prevent others from independently developing technologies that are equivalent to or superior to our technology. In addition, unauthorized parties may attempt to copy or otherwise obtain and use our proprietary technology. Monitoring unauthorized use of our technology is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries such as Taiwan, Korea, and China where the laws may not protect our proprietary rights as fully as do the laws of the United States. In addition, if the foundries that manufacture our semiconductors lose control of our intellectual property, it could be more difficult for us to take remedial measures because our foundries are located in countries that do not have the same protection for intellectual property that is provided in the United States. Also, some of our contracts, including license agreements, are subject to termination upon certain types of change-of-control transactions.

As of March 31, 2019, we have 1,456 patents and 1,281 pending applications worldwide. We cannot be certain that patents will be issued as a result of our pending applications nor can we be certain that any issued patents would protect or benefit us or give us adequate protection from competing products. For example, issued patents may be circumvented or challenged and declared invalid or unenforceable or provide only limited protection for our technologies. We also cannot be certain that others will not design around our patented technology, independently develop our unpatented proprietary technology or develop effective competing technologies on their own.

Failure to successfully defend against intellectual property lawsuits brought against us may adversely affect our business.

Companies in and related to the semiconductor industry often aggressively protect and pursue their intellectual property rights. From time to time, we have received, and may continue to receive, notices that claim we have infringed upon, misappropriated or misused other parties' proprietary rights. Moreover, in the past we were in litigation with parties that claim that we infringed their patents or misappropriated or misused their trade secrets. In addition, we or our customers may be sued by other parties that claim that our products have infringed their patents or misappropriated or misused their trade secrets, or that may seek to invalidate one or more of our patents. An adverse determination in any of these types of disputes could prevent us from manufacturing or selling some of our products, increase our costs of revenue and expose us to significant liability. Any of these claims may materially and adversely affect our business, financial condition and results of operations. For example, in a patent or trade secret action, a court could issue a preliminary or permanent injunction that would require us or our customer(s) to withdraw or recall certain products from the market or redesign certain products offered for sales or under development. We may also be liable for damages for past infringement and royalties for future use of certain technologies. See "Legal Proceedings" below.

In addition, any litigation to defend ourselves against claims that we have infringed the intellectual property rights of others, could, regardless of the ultimate outcome, materially and adversely affect our operating results by requiring us to incur significant legal expenses and diverting the resources of the company and the attention of our management team.

Because the markets in which we compete are highly competitive and many of our competitors have greater resources than we have, we cannot be certain that our products will compete favorably in the marketplace.

We face competition from a number of competitors, including Marvell and our flash memory customers. We expect to face competition in the future from our current and potential competitors. In addition, some of our flash memory customers have developed products and technologies that could replace their need for our products or otherwise reduce their demand for our products.

Some of our current and potential competitors have longer operating histories, greater name recognition, access to larger customer bases and significantly greater financial, sales and marketing, manufacturing, distribution, technical and other resources than we have. As a result, they may be able to respond more quickly to changing customer demands or to devote greater resources to the development, promotion and sales of their products than we can. Our current and potential competitors may develop and introduce new products that will be priced lower, provide superior performance or achieve greater market acceptance than our products. For our SSD solutions, if we are unable to procure sufficient supplies of flash memory, our customers may seek to purchase SSD solutions from other suppliers.

Our products must meet exacting specifications and undetected defects and failures may occur, which may cause customers to return or stop buying our products and may expose us to product liability risk and risks of indemnification against defects in our products.

Our products are complex and may contain undetected hardware or software defects or failures, especially when first introduced or when new versions are released. These errors could cause us to incur significant re-engineering costs, divert the attention of our engineering personnel from product development efforts and materially affect our customer relations and business reputation. If we deliver products with errors or defects, our credibility and the market acceptance and sales of our products could be harmed. Defects could also lead to liability for defective products as a result of lawsuits against us or against our customers. We have agreed to indemnify some of our customers in some circumstances against liability from defects in our products. A successful warranty or product liability claim could require us to make significant payments.

Our intellectual property indemnification practices may adversely impact our business.

We may be required to indemnify our customers and our third-party intellectual property providers for certain costs and damages of intellectual property infringement in circumstances where our products are a factor in creating infringement exposure. In the contracts under which we sell semiconductor products, we may have agreed to indemnify our customers against losses arising out of claims of unauthorized use of intellectual property. In some of our licensing agreements, we have agreed to indemnify the licensee against losses arising out of or related to our conduct or services. We cannot assure you that claims for indemnification will not be made or that these claims would not have a material and adverse effect on our business, operating results or financial condition.

We are exposed to potential impairment charges on goodwill and acquired intangible assets relating to acquisitions and on investments.

We had approximately US\$58.3 million of goodwill and US\$1.0 million of acquired intangible assets on our balance sheet as of December 31, 2018. We are required to perform testing for impairment losses annually or whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. If the fair value of the assets declines to below our carrying value, we could incur significant goodwill and intangible assets impairment charges, which could negatively impact our financial results. In November 2017, we wrote down FCI goodwill by US\$10.3 million. In November 2018, we wrote down Bigtera goodwill and intangible assets by US\$0.6 million and US\$3.4 million, respectively.

In addition, from time to time, we have made investments in private companies and had approximately US\$4.2 million of investments as of December 31, 2018. If the companies that we invested in are unable to execute their plans and succeed in their respective markets, we may not benefit from such investments, and we could potentially lose the amounts we invested. We evaluate our investment portfolio on a regular basis to determine if impairments have occurred. If the operations of any businesses that we have invested decline significantly, we could incur impairment charges that could have a material impact on our results of operations. In 2017, we recognized total impairment charges of US\$120 thousand for our Cashido and Vastview investments.

In April 2019, we reduced our Shannon sales forecast meaningfully, which is a triggering event that will require us to reevaluate our Shannon reporting unit's goodwill and intangible assets in the second quarter of 2019. See "Item 8. Recent Developments — Shannon Impairment Risk".

Any failure to achieve and maintain effective internal controls could have a material adverse effect on our business, results of operations and the market price of our ADSs.

We are subject to reporting obligations under securities laws of the United States. The Securities and Exchange Commission, or the SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, adopted rules requiring every public company to include in its annual report management's assessment of the effectiveness of the company's internal controls over financial reporting. In addition, an independent registered public accounting firm must attest to and report on the effectiveness of the company's internal controls over financial reporting.

Our management and independent registered public accounting firm have concluded that our internal controls as of December 31, 2018 are effective. However, we cannot assure you that in the future we or our independent registered public accounting firm will not identify material weakness during the audit process or for other reasons. In addition, because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. As a result, if we fail to maintain effective internal controls over financial reporting or should we be unable to prevent or detect material misstatements due to error or fraud on a timely basis, investors could lose confidence in the reliability of our financial statements, which in turn could harm our business and results of operations, negatively impact the market price of our ADSs and harm our reputation.

We are subject to cybersecurity risk.

We experience cyberattacks of varying degrees on our technology infrastructure and systems and, as a result, unauthorized parties have obtained in the past, and may in the future obtain, access to our computer systems and networks. The technology infrastructure and systems of our suppliers, vendors and partners may also experience such attacks. Cyberattacks are external and internal threats that include, but are not limited to, malware, phishing, advanced persistent threats, denial of service attacks, malicious software downloads, insider security breaches, and hardware and software vulnerabilities. We believe cyberattack attempts are increasing in number and that cyberattackers are developing increasingly sophisticated systems and means to not only attack systems, but also to evade detection or to obscure their activities.

We have controls and policies in place, will continue to enhance our capabilities and upgrade our protective solutions to guard against known and emerging threats, detect malicious or unauthorized activities, and have recovery systems to minimize business disruptions. If efforts to breach our infrastructure and systems are successful or we are unable to protect against these risks, we could suffer interruptions, delays, or cessation of operations of our systems, and loss or misuse of proprietary or confidential information, intellectual property, or sensitive or personal information. Breaches of our infrastructure and systems could also cause our customers and other affected third parties to suffer loss or misuse of proprietary or confidential information, intellectual property, or sensitive or personal information, and could harm our relationships with customers and other third parties. As a result, we could experience additional costs, indemnification claims, litigation, and damage to our brand and reputation. All of these consequences could harm our reputation and our business and materially and adversely affect our operating results and financial condition.

Laws and regulations to which we are subject, as well as customer requirements in the area of environmental protection and social responsibility, could impose substantial costs on us and may adversely affect our business.

We are subject to various state, federal and international laws and regulations governing the environment, including restricting the presence of certain substances in electronic products. In addition, we are also subject to various industry requirements restricting the presence of certain substances in electronic products. Although our management systems are designed to maintain compliance, we cannot assure you that we have been or will be at all times in complete compliance with such laws and regulations. If we violate or fail to comply with any of them, a range of consequences could result, including fines, import/export restrictions, sales limitations, criminal and civil liabilities or other sanctions.

Recently there has been increased focus on environmental protection and social responsibility initiatives, which are subject to change, can be unpredictable, and may be difficult for us to comply with, given the complexity of our supply chain and our significant outsourced manufacturing. We are required to implement various standards or processes due to the adoption of rules or regulations that result from these initiatives, such as the SEC rules on the disclosure of the use of “conflict minerals.” If we are unable to comply, or ensure that our suppliers or contract manufacturers comply, with such standards or processes, customers may stop purchasing from us, which could adversely affect our sales and results of operations.

Our stock price has been, and may continue to be, volatile, which could result in investors losing all or part of their investments.

Since we completed our initial public offering in June 2005, the market price of our ADSs has been and likely will continue to be highly volatile and could be subject to wide fluctuations in response to numerous factors, including the following:

- actual or anticipated variations in our quarterly operating results or those of our competitors, customers, or NAND flash vendors;
- actual or anticipated changes in NAND flash supply and demand dynamics;

- actual or anticipated changes in our market share or the market share of our competitors;
- the commencement or results of litigation;
- announcements by us, our competitors, our customers, or their other suppliers of new products or technological innovations;
- changes in financial estimates or recommendations by securities analysts;
- the payment or non-payment of cash dividends at the discretion of our board of directors;
- the announcement and implementation of share repurchase programs;
- announcements by us or our competitors of significant acquisitions, divestitures or partnerships; and
- actual or anticipated changes in the global economic or industry outlook.

Many of these factors are beyond our control and may negatively impact the market price of our ADSs, regardless of our performance. In addition, the stock market in general, and the market for technology and semiconductor companies in particular, have been highly volatile. Our ADSs may not trade at the same price levels as that of other semiconductor and technology companies, and shares of semiconductor and technology companies, in general, may not sustain their current market prices. These fluctuations as well as general economic, political, and market conditions may have an adverse effect on the market price of our ADSs.

There can be no assurance that we will continue to declare cash dividends on a quarterly basis, if at all or in any particular amounts.

Our Board of Directors declared payment of our first quarterly dividend on our common stock in January 2013 and the first dividend payment was made on March 4, 2013. Our Board of Directors has subsequently declared and paid dividends in each successive quarter. Beginning November 2, 2015 our Board of Directors, instead of declaring a quarterly dividend, declared an annual dividend payable in four quarterly installments. The continuation of declaring dividends or if at all, depends on, among other things, that the dividend payment is in the best interests of our shareholders, business visibility our results of operations, capital availability and future capital requirements, financial condition, statutory requirements, and other factors that the board of directors may deem relevant. The decision of any declaration of dividend payment, the amount and the frequency of such, if at all, is the discretion of our Board of Directors. Our dividend payments may change from time to time, and we cannot provide assurance that we will continue to declare dividends, if at all or in any particular amounts. A reduction in or elimination of our dividend payments could have a negative effect on our share price.

If we are characterized as a passive foreign investment company, U.S. Holders may experience adverse tax consequences.

Based on the present and projected composition of our income and valuation of our assets, we believe we are not currently classified as a passive foreign investment company (“PFIC”) for U.S. federal income tax purposes. We will generally be classified as a PFIC for any taxable year in which either (a) at least 75% of our gross income is passive income or (b) at least 50% of the value (determined on the basis of a quarterly average) of our assets is attributable to assets that produce or are held for the production of passive income. If we are characterized as a PFIC, U.S. Holders may experience adverse tax consequences. See “ITEM 10. ADDITIONAL INFORMATION — Taxation — United States Federal Income Taxation.”

We are subject to risks associated with international operations which may harm our business.

We conduct our business worldwide. We are a Cayman Islands corporation with principal executive offices in Hong Kong and have most of our operations outside of the United States. We undertake our design and development activities primarily in China, Korea and Taiwan. Our integrated circuits are manufactured,

assembled, tested and packaged by third-parties located primarily in China, Korea, and Taiwan. We generated 89%, 92% and 90% of our revenue in 2016, 2017 and 2018, respectively, from sales to customers outside the United States, and for the year ended December 31, 2018, 66% of our revenue was from sales in three jurisdictions — Taiwan, Korea and China. International operations are subject to many other inherent risks, including but not limited to:

- international economic and political conditions, such as political tensions between countries in which we do business (please also refer to Risk Factors relating to China, Korea, and Taiwan);
- unexpected changes in, or impositions of, legislative or regulatory requirements;
- complying with a variety of foreign laws;
- differing legal standards with respect to protection of intellectual property and employment practices;
- cultural differences in the conduct of business;
- inadequate local infrastructure that could result in business disruptions;
- exporting or importing issues related to export or import restrictions, tariffs, quotas and other trade barriers and restrictions, recently increased as a result of the ongoing trade disputes and tariffs between China and the U.S.;
- financial risks such as longer payment cycles and difficulty in collecting accounts receivable;
- adverse taxes rules, regulations and penalties; and
- other factors beyond our control such as nature disasters, terrorism, civil unrest, war and diseases such as severe acute respiratory syndrome, the Avian influenza, and the Swine influenza.

Although our reporting currency is the U.S. dollar, and the majority of our sales and cost of sales are denominated in the U.S. dollar, the majority of our operating expenses are denominated in the NT dollar, and to a lesser extent Korean won, Chinese yuan and U.S. dollar. The functional currencies of our Korean operations and our Chinese operations are the Korean Won and the Chinese yuan, respectively. As a result, appreciation or depreciation of other currencies in relation to the U.S. dollar could result in material transaction and translation gains or losses that could adversely affect, or cause fluctuations in, our results of operations. We do not currently engage in currency hedging activities.

We operate primarily in regions that are susceptible to natural disasters.

Parts of the world, including Taiwan, Japan, China and the United States are susceptible to earthquakes. In 1999, 2008, and 2011, Taiwan, China, and Japan respectively, experienced severe earthquakes that caused significant property damage and loss of life. Although the 1999, 2008 and 2011 earthquakes did not have a material impact on our business, and the region has not suffered such a major earthquake in many years, the occurrence of such an event is unpredictable, and a major earthquake and consequent disruptive events could severely disrupt the normal operations of our business and have a material and adverse effect on our financial condition and operating results.

We face substantial political risks associated with doing business in Taiwan because of the tense political relationship between Taiwan and the People's Republic of China.

A majority of our employees and a significant portion of our research and development and operations are based in Taiwan. In addition, most of our foundries and assembly and testing suppliers such as TSMC, SMIC, Advanced Semiconductor Engineering Group (“ASE”), Siliconware Precision Industries Co., Ltd. (“SPIL”), and King Yuan Electronics Corp. (“KYEC”) are located in either Taiwan or China. Accordingly, our business and results of operations and the market price of our ADSs may be affected by changes in Taiwan or China governmental policies, taxation, inflation or interest rates and by social instability and diplomatic and social

developments in or affecting Taiwan that are outside of our control. Taiwan has a unique international political status. China does not recognize the sovereignty of Taiwan. Although there have been significant economic and cultural ties between Taiwan and China in recent years, the political relations have often been strained. The government of China has indicated that it may use military force to gain control over Taiwan, particularly under what it considers as highly provocative circumstances, such as a declaration of independence by Taiwan or the refusal by Taiwan to accept China's "One China" policy. On March 14, 2005, the National People's Congress of China passed what is widely referred to as the "anti-secession" law, a law authorizing the Chinese military to attack Taiwan in order to block moves by Taiwan toward formalizing independence.

Past and recent developments in relations between Taiwan and China have on occasion depressed the market prices of the securities of Taiwanese companies or companies with significant business activities in Taiwan. We cannot assure you any contentious situations between Taiwan and China will always resolve in maintaining the current status quo or remain peaceful. Relations between Taiwan and China and other factors affecting military, political or economic conditions in Taiwan could have a material adverse effect on our financial condition and results of operations, as well as the market price and the liquidity of our ADSs.

We face substantial political risk associated from doing business in South Korea because of tensions in the political relationship between South Korea and North Korea.

Relations between South Korea and North Korea have been tense over most of South Korea's history. In recent years, there have been heightened security concerns stemming from North Korea's nuclear weapons and ballistic missile capabilities and uncertainty regarding North Korea's actions and possible responses from the international community. More recent concerns over North Korea's nuclear and ballistic missile testing programs, hostile and threatened actions by North Korea against South Korea, North Korea's leadership succession, and relations between the United States and North Korea, have created a global security issue that may adversely affect South Korean business and economic conditions. South Korea was not a signatory of the armistice agreement that ended the Korean War, and since no peace treaty was signed between South Korea and North Korea, the two countries are technically still at war. We cannot assure you as to whether or when this situation will be resolved or change abruptly as a result of current or future events, including, without limitation, the effects, if any, of (i) recent increases to previously imposed United Nations and U.S. sanctions on North Korea, and (ii) the general increase in overtures and rhetoric by the North Korean government with respect to its nuclear capabilities and willingness to use such weapons as they see fit. Although talks have recently been held between South Korea and North Korea and between the U.S. and North Korea, political instability has generally continued with the current U.S. administration. We cannot give any assurance that the level of instability and tension in the Korean peninsula will not escalate in the future, or that the political regime in North Korea may not suddenly collapse. An adverse change in economic or political conditions in South Korea or North Korea or in South Korea's relations with North Korea could have a material adverse effect on our South Korean subsidiaries and our company.

Our business depends on the support of the Taiwanese and South Korean governments, and a decrease in this support may increase our tax liabilities and decrease our net income.

Our Taiwan operating company has benefited from tax incentives provided by the Taiwanese government. For example, under the Statute for Upgrading Industries of Taiwan, we were granted tax credits by the Taiwan Ministry of Finance for qualifying research and development costs and in qualifying employee training expenses. In addition, Taiwan law offers preferential tax treatments to industries that are encouraged by the government. In 2010, "Statute for Industries Innovation" was passed to replace the "Statute for Upgrading Industries" in tax incentives. However, we are still eligible to use certain previously granted exemptions. See "Operating and Financial Review and Prospects — Principal Factors Affecting Our Results of Operations — Provision for income taxes" and Note 16 to our consolidated financial statements for a more detailed description of our ability to enjoy these preferential tax treatments. If any of our tax credits or our ability to take advantage of these preferential tax treatments are curtailed or eliminated, our net income may decrease materially. The last tax credit granted to us by the Taiwanese government expired at the end of 2016.

The South Korean government provides a variety of tax incentives designed to promote designated industries such as the technology industry. We, like many Korean technology companies, have benefited from certain tax incentives, including tax credits for applicable research and development expenses and for investments made to improve business productivity. If these and other tax incentives are curtailed or eliminated, our net income may decrease materially. In March, 2019, we announced that we had entered into an agreement to sell our interest in FCI to Dialog Semiconductor. See “*Item 8. Recent Developments*”.

The enactment of legislation implementing changes in taxation of international business activities, the adoption of other tax reform policies or changes in tax legislation or policies could materially impact our financial position and results of operations.

Tax bills are introduced from time to time to reform taxation of international business activities. The Organisation for Economic Co-operation and Development, or OECD, has released guidance covering various topics, including country-by-country reporting, definitional changes to permanent establishment and guidelines in determining arm’s length transfer pricing. This guidance is collectively referred to as Base Erosion and Profit Shifting, or BEPS, an initiative that aims to standardize and modernize global tax policy. Depending on legislation ultimately enacted in connection with this guidance by jurisdictions in which we operate, there may be significant consequences for us due to our significant international business activities. For example, adoption of BEPS by foreign jurisdictions in which we operate could result in changes to tax policies, including transfer-pricing policies that could ultimately impact our tax liabilities to foreign jurisdictions. If any of these proposals are enacted into law, or if other international, consensus-based tax policies and principles are amended or implemented, they could have material adverse consequences on the amount of tax we pay and thereby on our financial position and results of operations. It is likely that new legislations enacted by the governments of the Cayman Islands and Macau could lead to higher operating and tax expenses for our business in the near future.

In addition, policies regarding corporate income taxes in numerous jurisdictions in which we operate are under heightened scrutiny. As a result, decisions by tax authorities regarding treatments and positions of corporate income taxes could be subject to legislative investigation and inquiry, which could result in changes in tax policies or prior tax rulings. As such, the taxes we previously paid may be subject to change and our taxes may increase in the future, which could have an adverse effect on our results of operations, financial condition and our corporate reputation.

We are subject to risks associated with development and construction of our Taiwan headquarters building.

In October 2018, we purchased 65,700 square feet of land in Hsinchu, Taiwan for a total cost of \$58.9 million and expect to spend an estimated \$75 million for the development and construction of our future Taiwan headquarters building, which is currently targeted for completion in 2024. We have no experience developing and constructing office buildings and managing real property of this scale. We may encounter unanticipated occurrences or conditions during construction that may increase the expense of the project. We may also encounter unanticipated delays in the construction of the new building and local government approvals for the project may be delayed. We are financing this construction from our cash balance, which could limit alternative deployments of capital. The purchase of the land and construction of the building will increase our fixed assets significantly and could reduce our return on invested capital. We are also exploring built-to-suit arrangements to reduce investments in fixed assets, but built-to-suit may not be obtainable at favorable terms; alternatively, once the office building has been constructed, we may consider a sale and leaseback if favorable terms can be obtained.

ITEM 4. INFORMATION ON THE COMPANY

Introduction

Silicon Motion Technology Corporation (“Silicon Motion”) is a corporation which was incorporated in the Cayman Islands in January 2005 and acquired Silicon Motion, Inc., a Taiwan corporation (“SMI Taiwan”), in

April 2005. Originally SMI Taiwan was known as Feiya Technology Corporation (“Feiya”), a Taiwan corporation which was incorporated in April 1997 but had changed its name to SMI Taiwan after acquiring in August 2002 Silicon Motion, Inc., a California corporation (“SMI USA”), which was incorporated in November 1995. Feiya was originally a flash memory products company and SMI USA a graphics processor company.

On March 7, 2019, we entered into an agreement to sell FCI, our specialty RF IC product line for the Mobile Communications market, to Dialog Semiconductor. See “Item 8. Recent Developments — Sale of FCI”.

We are a global leader and pioneer in developing NAND flash controller ICs for solid-state storage devices. We sell more NAND flash controllers than any other company in the world and have one of the broadest portfolios of controller solutions and technologies. Our key products are controllers used in embedded storage products such as SSDs, eMMCs, and UFS, as well as in expandable storage products such as memory cards and USB flash drives. Our products are widely used in computing and mobile devices and for industrial, enterprise, commercial and other applications. Our customers include most of the NAND flash makers, leading technology OEMs, and the majority of storage device module makers. More NAND flash products, especially next-generation flash, produced by Intel, Micron, Samsung, SK Hynix, Toshiba and Western Digital are supported by Silicon Motion controllers than any other company. We are the world’s leading merchant supplier of controllers for eMMC and UFS embedded memory used in smartphones and tablets, and the leading merchant supplier of controllers for client SSDs used in PCs and other applications. We also supply customized specialty SSD solutions for industrial, commercial and automotive applications and the Chinese hyperscale data center market. We market our controllers under the “SMI” brand, our data center-grade SSDs under the “Shannon” brand, our single-chip industrial-grade SSDs under the “Ferri SSD” and “Ferri-eMMC” brands, specialty RF ICs under the “FCI” brand, and software-defined storage under the “Bigtera” brand.

Our principal executive offices are located at Unit 04-05, 27/F, #909 Cheung Sha Wan Rd., Kowloon, Hong Kong. The address of our United States operating subsidiary, Silicon Motion, Inc., is 690 N. McCarthy Blvd. Suite 200, Milpitas, CA 95035. The address of our Taiwan operating subsidiary, Silicon Motion, Inc., is 8/F, #36 Taiyuan St., Jhubei, Hsinchu 30265, Taiwan. Our ADSs, each representing four of our ordinary shares, have been listed and traded on Nasdaq since June 2005.

Subsidiaries of the Company

Below is a list of subsidiaries of the Company. All subsidiaries are wholly owned.

<u>Name of Entity</u>	<u>Jurisdiction of Incorporation</u>
Bigtera (Beijing)	China
Shannon Systems	China
Silicon Motion, Inc.	California
Silicon Motion, Inc.	Taiwan
Silicon Motion, Inc. (Shanghai)	China
Silicon Motion, Inc. (Shenzhen)	China
Silicon Motion (MCO) Ltd.	Macau
Silicon Motion Technology (HK) Ltd.	Hong Kong
FCI Inc.*	Korea

* In March 2019, we announced that we had entered into an agreement to sell our interest in FCI to Dialog Semiconductor. See “Item 8. Recent Developments”.

Our Market and Products

We focus primarily on designing, developing and marketing: (i) controllers for managing NAND flash used in embedded storage, such as eMMC devices and SSDs, and expandable storage, such as flash memory cards and

USB flash drives, (ii) customized enterprise-grade SSD solutions for Chinese hyperscalers' data centers and customized SSD solutions for industrial, commercial and automotive applications, and (iii) specialty RF ICs. NAND flash controllers account for a significant majority of our sales. NAND flash controllers and SSD solutions are products for the Mobile Storage market and RF ICs are products for the Mobile Communications market.

See "Item 8. Recent Developments — Sale of FCI".

NAND Flash Controllers

NAND flash controllers are used to manage NAND flash, a type of non-volatile semiconductor memory manufactured by vendors such as Intel, Micron, Samsung, SK Hynix, Toshiba and Western Digital, used in solid state storage devices designed into smartphones, PCs and industrial, enterprise and data center applications. Solid state storage devices are widely used by OEMs and consumers in applications because of attractive characteristics that include high data storage capacity at low cost per bit, fast data read and write access time, low operating power requirements, small form-factor and shock resistance, which has led to applications using solid state storage devices proliferating and SSDs, a type of solid state storage device, displacing HDDs, a legacy type of storage device that uses electro-mechanical components.

All solid state storage devices using NAND flash require a controller, with most using a discrete controller IC and complementary firmware. Different types of controllers are used to develop different types of storage devices, for example an SSD controller is used specifically to develop an SSD and a UFS controller used to develop a UFS device, and controllers create different types of storage devices by providing the defining interface for the storage device type, delivering performance specified for the storage device type, managing NAND flash used in the storage device and implementing other necessary functionality.

There are many different types of solid state storage devices that use NAND flash, including SSDs used in PCs and other client devices, data centers and enterprise applications and eMMC and UFS used in smartphones and other smart devices. These different types of storage devices are developed using different types of specialized controllers, which enable the storage device to communicate with the host device according to the protocol defined for the specific interface. For example, PCIe NVMe SSDs require controllers that can interface according to the NVMe data transfer protocol for the PCIe data transfer system within a PC or server and UFS devices require controllers that can interface with the smartphone host device according to the UFS protocol. The storage device must deliver performance standards specified for the storage type according to the interface protocol and storage device performance is delivered by the controller utilized. Furthermore, controllers are often configured by OEMs to deliver optimized storage device operating performance relating to required metrics that include data transfer rates, IOPS (input/output operations per second), latency and stability.

In addition to providing the defining interface for a storage device and delivering specified performance requirements, the controller importantly must also manage NAND flash used in the storage device to: (i) ensure data reliability in NAND flash by detecting and correcting bit errors caused by read/write disturbance and adjacent cell interference; (ii) ensure data integrity in NAND flash by mapping bad blocks and preventing bad blocks from being used for storing data; (iii) maximize the life of NAND flash with wear-leveling algorithms which spread out the use of the memory array and equalize the use of all the memory cells; (iv) enhance the sequential and random read and write performance of NAND flash by utilizing multiple-plane architecture, interleaving, or other technologies; and (v) prevent data loss during sudden, unexpected host device power failures with advanced power cycling solutions. NAND flash from different vendors and from different generations of technology in terms of multi-level cell architecture (for example, 2-bits per cell, 3-bits per cell and 4-bits per cell) designed for 3D NAND flash at different layer stacking (for example, 64 layer, 72 layer, 92/96 layer) have different performance characteristics, which require different controller technology to provide suitable NAND flash management.

OEMs designing storage devices may require controller vendors to implement other functionalities such as: security for protecting software code, personal data and multimedia digital rights; end-to-end data path protection

to protect data inside a storage device, from the connection to the host system, through the circuits of the storage device, to the NAND flash; power-loss security features; Opal-compliant AES advanced full-disk encryption; and active operating temperature monitoring. Finally, controllers are designed to ensure that storage devices are compatible with a wide set of designated host devices and can be tuned to maximize compatibility and performance requirements.

We provide NAND flash controllers for many key applications, including: (i) high performance, cost effective client SSDs for PCs and other consumer-grade applications; (ii) enterprise-grade SSDs optimized for demanding data center and enterprise workload; (iii) embedded SSDs designed and tested for industrial, commercial and automotive applications; (iv) eMMC and UFS embedded memory for smartphones and other smart or IOT devices; and (v) memory cards and flash drives.

SSD Solutions

We have leveraged our unique controller technology to develop customized SSD solutions. Our Ferri and Shannon products are SSD solutions developed using our controllers and procured NAND flash for markets under-served by our module maker and NAND flash customers. Our FerriSSDs and Ferri-eMMCs are highly reliable industrial-grade, commercial-grade and automotive-grade single-chip SSDs, which are developed for a wide-range of embedded applications that require high data rate, small form factor and compliance with standard interface protocols and for a diversified group of OEMs located mainly in Japan, the US and China. Our Shannon SSDs are primarily customized enterprise-grade PCIe NVMe SSDs and Open Channel SSDs developed for China's hyperscale customers' data center applications. Our Bigtera software-defined storage solutions are enterprise-grade software defined storage and storage appliances targeted at China and Taiwan markets.

Specialty RF ICs

Mobile TV SoCs. Our products include integrated mobile TV tuner plus demodulator SoCs for mobile phones and other portable devices. Our solutions are designed for leading digital mobile TV broadcast standards, specifically Terrestrial-Digital Media Broadcast (T-DMB) for the Korean market and Integrated Services Digital Broadcasting-Terrestrial (ISDB-T) for the Japanese and certain Asian and South American markets.

Low Power Wi-Fi SoCs. We offer ultra-low power Wi-Fi SoCs for addressing smart home, commercial, and industrial applications. Specific target applications include smart thermostats and other sensors, video surveillance cameras, smart door locks and video door bells.

See "Item 8. Recent Developments — Sale of FCI".

Our Customers

We sell our semiconductor solutions to NAND flash manufacturers, leading technology OEMs and module makers worldwide. Most of our high performance flash memory storage controllers are supplied to NAND flash manufacturers. We are a leading merchant supplier of controllers for SSDs used in PCs and other client devices, eMMC used in smartphones, flash memory cards and USB flash drives.

Sales to our five largest customers represented approximately 58%, 57% and 54% of our net revenue in 2016, 2017 and 2018, respectively. Sales to two customers in 2017 and 2018, and one customer in 2016 accounted for 10% or more of our net revenue, representing 28%, 39% and 34% of our net revenue in 2016, 2017 and 2018, respectively. In 2017 and 2018, the significant customers were SK Hynix and Intel and in 2016, SK Hynix. The identities of our largest customers and their respective contributions to our net revenue have varied and will likely continue to vary from period to period.

The majority of our customers purchase our products through purchase orders, as opposed to entering into long-term contracts with us. The price for our products is typically agreed upon at the time a purchase order is placed.

Sales and Marketing

We market and sell our products worldwide through a combination of direct sales personnel and independent electronics distributors. Our direct sales personnel are strategically located near our NAND flash manufacturer, leading technology OEM and modular maker customers in Taiwan, Korea, China, the United States, and Japan. Approximately 69% of our sales in 2016, 68% of our sales in 2017, and 68% of our sales in 2018 were attributable to our direct sales force while the remainder was attributable to distributors.

To supplement our direct sales, we have independent electronics distributors and sales reps located throughout the world. We selected these distributors and reps based on their ability to provide effective field sales, marketing communications and technical support for our products to our customers.

Our marketing group focuses on our product strategy, product development road maps, new product introduction process, demand assessment, competitive analysis, and product marketing. We seek to work with potential and existing customers early in their design process to best match our products to their needs, and more broadly, to ensure that product development activities, product launches, and on-going demand and supply planning occur in a well-managed, timely basis in coordination with our research and development, operations, and sales groups, as well as our customers and distributors. We also attend industry tradeshows and technical conferences to promote our products and solutions, maintain close contact with our existing customers to assess demand, and keep current with industry trends. Our participation in industry standards associations, such as JEDEC and the SD Association for our embedded storage and expandable storage products, helps us monitor the latest industry developments and promote our corporate profile. Our marketing group also works with our sales teams to identify new business opportunities.

We also have field application engineers (FAEs), who provide technical support and assistance to existing and potential customers in designing, testing and qualifying systems that incorporate our products. Our FAE organization is segmented by product and market to support our customers.

Research and Development

We devote a significant amount of resources to research and development for broadening and strengthening our portfolio of technology, products and solutions. Our engineering team has expertise in NAND flash management algorithms, system architecture, digital, mixed-signal and RF IC design, and software engineering. As of March 31, 2019, we have 1,456 patents and 1,281 pending applications worldwide. We will continue to actively pursue the filing of additional patent applications in important jurisdictions.

We believe technology research and product development is essential to our growth. Our primary research and development centers are located in Hsinchu and Taipei, Taiwan, Seoul, South Korea and Shanghai, China. Our facilities in Seoul focus primarily on our specialty RF IC products, our facilities in Hsinchu and Taipei focus primarily on our NAND flash controller products, and our facilities in Shanghai focus primarily on SSD solutions and specific product requirements of our customers in China.

Our research and development expenses were approximately US\$92.4 million, US\$102.1 million, and US\$102.0 million for the years ended December 31, 2016, 2017 and 2018, respectively.

Manufacturing

We design and develop our products and electronically transfer our proprietary designs to independent foundries for the manufacturing and processing of silicon wafers. Once the wafers are manufactured, they are then shipped to third-party assembly and testing subcontractors. Individual dies on each wafer are assembled into finished chips and undergo several stages of testing before delivery to our customers. We also ship bare dies to our customers. We believe that our strategy of outsourcing wafer fabrication, packaging and testing enables us to

benefit from the research and development efforts of leading manufacturers without the requirement to commit our own substantial capital investments. Our fabless business model also provides us with the flexibility to engage vendors who offer services that best complement our products and technologies.

Wafer fabrication. TSMC and SMIC are currently our primary foundries that manufacture most of our semiconductors. We use their fabs in Taiwan, Singapore, and China to fabricate our devices using mature and stable CMOS process technology, primarily with process node from 28 to 55 nanometers. We regularly evaluate the benefits and feasibility, on a product-by-product basis, of migrating to more cost efficient manufacturing process technologies.

Assembly and testing. Following wafer fabrication, our wafers are shipped to our assembly and test subcontractors where they are probed, singulated into individual dies, assembled into packaged chips, and undergo the process of electronic final testing. In order to minimize cost and maximize turn-around time, our products are designed to use low cost, industry standard packages and can be tested with widely available automatic testing equipment. We currently engage companies such as ASE, SPIL, and KYEC as our primary subcontractors for the assembly and testing of our products. We have dedicated teams of manufacturing engineers who maintain control over the process from the early stages of manufacturing. Our engineers work closely with our subcontractors to develop product testing and packaging programs to ensure these programs meet our product specifications, thereby maintaining our ownership of the functional and parametric performance of our semiconductors.

Quality and reliability assurance. We have designed and implemented a quality assurance system that provides the framework for continual improvement of products, processes and customer service. To ensure consistent product quality, reliability and yield, our quality assurance teams perform reliability engineering, quality control, international organization for standardization (ISO) system development, document control, subcontractor quality management and customer engineering services to closely monitor the overall process from IC design to after-sale customer support. In particular, we rely on in-depth simulation studies, testing and practical application testing to validate and verify our products. We emphasize a strong supplier quality management practice in which our manufacturing suppliers and subcontractors are pre-qualified by our quality assurance teams. Our suppliers are required to have a quality management system, certified to ISO 9000 standard. Our operations have been ISO 9001 certified since 1999.

Competition

We face competition from a number of competitors, including Marvell and our flash memory customers.

The markets for our products are intensely competitive, and are characterized by rapid technological change, evolving industry standards, frequent new product introductions and pricing pressures. Competition has intensified as a result of the increasing demand for higher levels of performance at competitive prices. We expect competition to intensify as current competitors continue to strengthen the depth and breadth of their product offerings. We believe that our ability to compete successfully in the rapidly evolving markets for our products depends on a number of factors, including, but not limited to:

- the performance, features, quality and price of our products;
- the timing and success of new product introductions by us, our customers and our competitors;
- emergence, rate of adoption and acceptance of new industry standards;
- our ability to obtain adequate foundry capacity at competitive prices; and
- the number and nature of our competitors in a given market.

We expect increased competition in the future from emerging or established companies, customers or other third parties, any of which could acquire significant market share. See “Risk Factors” — Because the markets in

which compete are highly competitive and many of our competitors have greater resources than we have, we cannot be certain that our products will compete favorably in the market place in Item 3 above.

Seasonality

See “Risk Factors — Because our operating results for any period could be adversely affected by a number of factors and therefore fluctuate significantly, our annual and quarterly operating results are difficult to predict” in Item 3 above and “Operating and Financial Review and Prospects — Principal Factors Affecting Our Results of Operations” in Item 5 below.

Intellectual Property

Our success and future revenue growth depends, in part, on our ability to protect our intellectual property. We rely on a portfolio of intellectual property rights, registered in the United States, Taiwan, and other countries, including patents, copyrights, trademark registrations, trade secret laws, contractual provisions, licenses, and other methods to protect our intellectual property.

As of March 31, 2019, we have 1,456 patents and 1,281 pending applications worldwide. There can be no assurance that patents will ever be issued with respect to these pending applications. Furthermore, it is possible that any patents held by us may be invalidated, circumvented, challenged or licensed to others. In addition, there can be no assurance that such patents will provide us with competitive advantages or adequately safeguard our proprietary rights. While we continue to file new patent applications with respect to our recent developments, existing patents are granted for prescribed time periods and will expire at various times in the future. We expect to continue to file patent applications where appropriate to protect our proprietary technologies.

Companies in the semiconductor industry have frequently demonstrated a readiness to commence litigation based on allegations of patent and other intellectual property infringement. From time to time, third parties may assert infringement claims against us. We may not prevail in any such litigation or may not be able to license patents from third parties on commercially reasonable terms, if at all. Litigation, regardless of the outcome, is likely to result in substantial cost and diversion of our resources, including our management’s time. Any such litigation could materially adversely affect us. In addition, in the contracts under which we sell semiconductor products, we may have agreed to indemnify our customers against losses arising out of claims of unauthorized use of intellectual property.

We intend to protect our intellectual property rights vigorously, but there can be no assurance that our efforts will be successful. In addition, the laws of other countries in which our products are sold may not protect our products and intellectual property rights to the same extent as the laws of the United States.

While our ability to effectively compete depends in large part on our ability to protect our intellectual property, we believe that our technical expertise, customer support capabilities, and ability to introduce new products in a timely and cost effective manner will be important factors in maintaining our competitive position.

We claim copyright and trademark protection for proprietary documentation for our products and a variety of branding marks. We have registered “Silicon Motion” and its logo (a three-dimensional cube depiction of the letters “SM”), FCI, the FCI logo, the Shannon Systems logo, “PCIe-RAID,” “DIRECT-IO,” “Hyper-IO,” “airRF,” “basicRF,” “ezRF,” “ezSYS,” “powerRF,” “twinRF,” “zipRF,” “zipSYS,” “VirtualZero,” “SSDLifeGuard,” “SSDLifeSaver,” “TurboMLC,” “FerriSSD,” “Ferri-eMMC,” “Bigtera,” the Bigtera logo, and “NANDXtend” as trademarks in the United States, Taiwan, and other countries.

We also attempt to protect our trade secrets and other proprietary information through agreements with our customers, suppliers, employees and consultants, and through other customary security measures.

We have entered into license agreements with third party intellectual property vendors for wafer fabrication tool libraries, semiconductor IP core, computer aided design tools, and software.

Facilities

As of the date of this annual report, we occupy facilities totaling approximately 419,500 square feet, which house our management and administration, operations, research and development and sales and marketing departments. Of our facilities, approximately 182,400 square feet are owned and approximately 237,100 square feet are occupied under leases. We consider our facilities insufficient to meet our future operational requirements and in 2018, purchased 65,700 square feet of land in Hsinchu, Taiwan for the construction of a future office building. See “Risk Factor” — We are subject to risks associated with the development and construction of our Taiwan headquarters building. The table below lists the location of our operating facilities.

<u>Location</u>	<u>Primary Use</u>	<u>Approximate Square Footage</u>
Hsinchu, Taiwan	Research & development, management & administration	200,800
Taipei, Taiwan	Research & development, sales & marketing	67,000
Seoul, Korea ⁽¹⁾	Research & development, sales & marketing	52,500
Shanghai, China	Research & development, sales & marketing	43,400
Shenzhen, China	Sales & marketing	21,400
Milpitas, California	Sales & marketing, management	13,300
Others ⁽²⁾	Sales & marketing, management	21,100

(1) In March 2019, we announced that we had entered into an agreement to sell our interest in FCI to Dialog Semiconductor. See “Item 8. Recent Developments”.

(2) Hong Kong, Macau, Yokohama, Japan, Beijing, Nanjing, Hangzhou, Suzhou, China

Leases covering our current facilities expire at varying dates, generally within the next five years. We anticipate no difficulty in retaining occupancy through lease renewals, month-to-month occupancy or replacing the leased facilities with equivalent facilities.

We currently own commercial property in Taipei of approximately 6,200 square feet and commercial property in Shanghai of approximately 20,000 square feet, which we have no plans to use for our operations. We are in the process of selling the Shanghai properties.

Government Regulation

See Risk Factors — “We face substantial political risks associated with doing business in Taiwan because of the tense political relationship between Taiwan and the People’s Republic of China,” “We face substantial political risk associated from doing business in South Korea because of tensions in the political relationship between South Korea and North Korea,” and “Our business depends on the support of the Taiwanese and South Korean governments, and a decrease in this support may increase our tax liabilities and decrease our net income” in Item 3 above.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion of our financial condition and results of operations is based upon and should be read in conjunction with our consolidated financial statements and their related notes included in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. We caution you

that our business and financial performance are subject to substantial risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. See “Special Note Regarding Forward-Looking Statements.” In evaluating our business, you should also carefully consider the information provided under the caption “Risk Factors” included in Item 3 of this annual report.

Overview

We are a global leader and pioneer in developing NAND flash controller ICs for solid-state storage devices. We sell more NAND flash controllers than any other company in the world and have one of the broadest portfolios of controller solutions and technologies. Our key products are controllers used in embedded storage products such as SSDs and eMMCs, as well as in expandable storage products such as memory cards and USB flash drives. Our products are widely used in computing and mobile devices and for industrial, enterprise, commercial and other applications. Our customers include most of the NAND flash makers, leading technology OEMs, and the majority of storage device module makers. More NAND flash products, especially next-generation flash, produced by Intel, Micron, Samsung, SK Hynix, Toshiba and Western Digital are supported by Silicon Motion controllers than any other company. We are the world’s leading merchant supplier of controllers for eMMC embedded memory used in smartphones and tablets, and the leading merchant supplier of controllers for client SSDs used in PCs and other applications. We also supply customized specialty SSD solutions for the Chinese hyperscale data center market and for high-performance industrial applications. We market our controllers under the “SMI” brand, our enterprise-grade SSDs under the “Shannon” brand, our single-chip industrial-grade SSDs under the “Ferri SSD” and “Ferri-eMMC” brands, specialty RF ICs under the “FCI” brand, and software-defined storage under the “Bigtera” brand.

Summary of Consolidated Financial Results

As discussed in more detail below, for the year ended December 31, 2018, compared to the year ended December 31, 2017, we delivered the following financial performance.

- Total revenue increased by 1% to \$530.3 million.
- Gross profit as a percentage of revenue increased by 1.2% points to 49.2%.
- Total operating expenses increased by less than 1% to \$156.0 million.
- Operating profit increased by 10% to \$104.8 million.
- Income tax expense as a percentage of income before income tax decreased by 14% points to 11%.
- Diluted earnings per ADS increased by 30% to \$2.71.

The increase in our revenue for the year ended December 31, 2018 was primarily the result of SSD controller sales increasing by about 30%, partially offset by eMMC plus UFS controller sales decreasing by about 10% and SSD solutions sales decreased by about 5%. SSD controller sales were nearly 40% of total revenue, eMMC plus UFS controller sales were in the range of 25% to 30% of total revenue and SSD solutions sales were nearly 20% of total revenue.

Total operating expenses were stable in 2018 primarily due to lower impairment loss of goodwill and intangible assets, offset by increased sales and marketing and other expenses. Impairment loss of goodwill and intangible assets was \$6.3 million lower in 2018; in 2017 we recognized a one-time \$10.3 million impairment loss of goodwill relating to our FCI acquisition and in 2018 we recognized a one-time \$4.1 million impairment loss of goodwill and intangible assets related to our Bigtera acquisition. In 2017, we benefited from a one-time \$1.9 million gain relating to the sale of our Shanghai property. Sales and marketing expenses were \$3.4 million higher, primarily due to higher Bigtera headcount expenses, as well as larger expenditures for technical services and samples.

Our earnings per share increased primarily due to lower income taxes, increase in gross margin and lower operating expenses.

Principal Factors Affecting Our Results of Operations

Net sales. Our net sales consist primarily of sales of our products, after deducting sales discounts and allowances for returns.

Our net sales are denominated primarily in U.S. dollars. The percentages of our net sales by currency for the periods indicated are set forth in the following table:

	<u>Year Ended December 31,</u>		
	<u>2016</u>	<u>2017</u>	<u>2018</u>
Currency			
U.S. dollars	92%	87%	88%
Korean won	3%	3%	3%
Chinese yuan	5%	10%	9%

The length of our sales cycle, from the day purchase orders are received until products are shipped to customers, is dependent on the availability of our product inventories. If we do not have sufficient inventories on hand to meet customer demands, approximately three months are generally required from the day purchase orders are received until finished goods are manufactured and shipped to customers. This cycle can take up to six months during times when capacity at independent foundries is being fully utilized. The potential delays inherent in the manufacturing process increase the risk that we may not be able to fulfill a customer’s order on time. All of our sales are made by purchase orders. Because our practice, which is consistent with industry practice, allows customers to reschedule orders on relatively short notice, order backlog may not be a good indicator of our future sales.

Because many of our semiconductor solutions are designed for the mobile and computing devices markets, we expect our business to be subject to seasonality, with higher net sales generally in the second half of each year, when customers place orders to meet increased demand during year-end holiday seasons. However, our rapid sales growth and changing product mix in recent years could make assessment of the impact of seasonal factors on our business difficult.

Cost of sales. Our cost of sales consists primarily of the following costs:

- cost of wafer fabrication;
- assembly, testing and shipping costs of our semiconductors;
- personnel and equipment costs associated with manufacturing support;
- quality assurance;
- cost of raw materials; and
- write-down of inventory.

We engage independent foundries for the manufacturing and processing of our semiconductors. Our manufacturing cost is subject to the cyclical supply and demand conditions typical of the semiconductor industry. Our cost per wafer generally fluctuates with the availability of capacity at independent foundries. We believe that our cost of sales is substantially variable in nature.

Research and development expenses. Our research and development expenses consist primarily of employee salaries and related costs, stock-based compensation expense, fees paid for the use of intellectual properties and design tools developed by third parties, development cost of software, expenses for the design, development and

testing of system architecture, new product or product alternatives, costs for the construction of prototypes, occupancy costs and depreciation on research and development related equipment. We expense research and development expenditures as they are incurred.

Sales and marketing expenses. Our sales and marketing expenses consist primarily of employee salaries and related costs, stock-based compensation expense, commissions paid to independent distributors and costs for our advertising and promotional activities.

General and administrative expenses. Our general and administrative expenses consist primarily of employee salaries and related costs, stock-based compensation expense, insurance premiums, professional fees and allowance for doubtful accounts.

Impairment of goodwill and intangible assets. We evaluate the recoverability of goodwill and intangible assets annually, or sooner if events or changes in circumstances indicate that the carrying amount may not be recoverable.

Amortization of acquired intangible assets. Amortization of acquired intangible assets relates to intangible assets, such as development technology, but excluding goodwill.

Gain from disposal of noncurrent assets held for sale. We sold an office building which was classified as noncurrent assets held for sale and recognized the gain from disposal.

Accounting for stock-based compensation. We grant both stock options and restricted stock units to our employees and members of the Board of Directors. The value of our restricted stock units is expensed over the vesting period and based on the grant date share price, less the present value of expected dividends during the vesting period, discounted at a risk-free interest rate.

Non-operating income and expenses. Our non-operating income and expenses include gains or losses on the sales of investments, interest from deposited cash or short-term investments, gains or losses on foreign exchange rates, impairment of long-term investments, interest paid on loans and capital leases, gain or loss on equity-method investment and other non-operating income and expenses not categorized above. We conduct an assessment on the value of our long-term investments quarterly and make corresponding write-downs as required to the value of the long-term investments.

Provision for income taxes. We must make certain estimates and judgments in determining income tax expenses for financial statement purposes. These estimates and judgments occur in the calculation of tax credits, benefits, deductions and allowance, and in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes, as well as the interest and penalties related to uncertain tax positions.

We have operations in several countries, which include Taiwan, China, Hong Kong, Macau and Korea, and determine income taxes for each of the jurisdictions where we operate.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States.

The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, net sales and expenses, and related disclosure of contingent assets

and liabilities. We evaluate our estimates on an on-going basis, including those related to product returns and pricing allowances, allowances for doubtful accounts, inventories, business combinations, goodwill, long-lived assets, income taxes, litigation and contingencies. We base our estimates and judgments on our historical experience, knowledge of current conditions and our beliefs of what could occur in the future considering available information. Because our estimates may vary in each situation, our actual results may differ from our estimates under different assumptions and conditions.

Our management considers the following factors in reviewing our financial statements:

- the selection of critical accounting policies; and
- the judgments and other uncertainties affecting the application of those critical accounting policies.

The selection of critical accounting policies, the judgments and other uncertainties affecting the application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing our financial statements. Our principal accounting policies are set forth in detail in Note 2 to our consolidated financial statements included elsewhere in this annual report.

We believe the following critical accounting policies affect our more significant judgments used in the preparation of our financial consolidated statements.

Revenue recognition. As a result of the adoption of the new revenue standard (ASC 606) on January 1, 2018, The Company enters into contracts that may include products that are capable of being distinct and accounted for as separate performance obligations. To date, the majority of the revenue has been generated by sales associated with products of storage and mobile communication, where a single performance obligation is identified in general. Revenue from services has been insignificant. Performance obligations associated with product sales transactions are generally satisfied when control passes to customers upon shipment or the written acceptance of the customers. Accordingly, product revenue is recognized at a point in time when control of the asset is transferred to the customer. The Company recognizes revenue when it satisfies a performance obligation by transferring control of a product to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods. Some of the Company's sales are made to distributors. Control passes to the distributor upon shipment, and terms and payment by the Company's distributors is not contingent on resale of the product.

The Company grants certain distributors limited rights of return and price protection rights on unsold products. The return rights are generally limited to five percent of the monetary value of products purchased within the preceding six months, provided that the distributor places a corresponding restocking order of equal or greater value. An allowance for sales returns for distributors and all customers is recorded at the time of sale based on historical returns information available, management's judgment and any known factors at the time the financial statements are prepared that would significantly affect the allowance. Price protection rights are based on the inventory products the distributors have on hand at the date the price protection is offered. The actual price adjustments to distributors incurred by the Company are minimal.

Allowance for doubtful accounts. We record an allowance for doubtful accounts based on our evaluation of the collectability of our accounts receivable. Normal payment terms are provided to customers and applied upon transfer of title. On an ongoing basis, we analyze the payment history of customer accounts, including recent customer purchases. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us, we record a specific allowance against amounts due to reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other accounts receivable due from customers, we categorize accounts receivable and make provisions based on a percentage of each category. We determine these percentages by examining our historical collection experience and current trends in the credit quality of our customers as well as our internal credit policies. If the financial condition of our customers or economic

conditions in general were to deteriorate, additional allowances may be required in the future and such additional allowances would increase our operating expenses and therefore reduce our operating income and net income.

Our allowance for trade-related doubtful accounts were approximately US\$0.7 million, US\$0.6 million and US\$0.6 million as of December 31, 2016, 2017 and 2018, respectively, representing approximately 1.0%, 0.7% and 0.7% of our gross accounts receivables at the end of each respective periods.

Inventory valuation. We value inventories at the lower of cost or market value. Inventories are recorded at standard cost and adjusted to the approximate weighted-average cost at the balance sheet date. Market value represents the current replacement cost for raw materials, finished goods and work in process. We write down our inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we projected, additional inventory write-downs may be required. Inventory impairment charges establish a new cost basis for inventory and charges are not subsequently reversed to income even if circumstances later suggest that increased carrying amounts are recoverable. In estimating our reserves for obsolescence, we primarily evaluate estimates based on the timing of the introduction of our new products and the quantities remaining of our old products and write down the value of inventory on hand in excess of the estimated demand. We wrote down US\$3.0 million, US\$0.7 million and US\$2.1 million in 2016, 2017 and 2018, respectively, for estimated obsolete or unmarketable inventory.

Valuation of long-lived assets and intangible assets with finite useful life. We evaluate the recoverability of long-lived assets and intangible assets whenever events or changes in circumstances indicate the carrying value may not be recoverable. The carrying value of a long-lived asset is considered impaired when the sum of the anticipated undiscounted cash flows from such asset is separately identifiable and is less than the carrying value. If impairment occurs, a loss based on the excess of carrying value over the fair market value of the long-lived asset is recognized. Fair market value is determined by reference to quoted market prices, if available, or discounted cash flows, as appropriate. The impairment evaluations and the estimate of fair market value involve management estimates of assets' useful lives and future cash flows. Actual useful lives and cash flows could be different from those estimated by management. This could have a material effect on our operating results and financial condition. No impairment losses were recognized in 2016 and 2017. In 2018, we wrote down the value of intangible assets by US\$3.4 million. See Note 11 goodwill and acquired intangible assets in our financial statements.

Impairment of long-term investments. We evaluate the recoverability of long-term investments whenever events or changes in circumstances indicate the carrying value may not be recoverable. Impairment charges are determined based on the difference between our carrying value and our proportionate ownership of the investee company's fair value at year end. In 2016, 2017 and 2018, we recognized long term investments impairment of US\$13 thousand, US\$120 thousand and nil, respectively, as a result of recurring operating losses and reduced forecasts of the investee companies which indicated that our investments were not recoverable within a reasonable period of time.

Business combinations. When we acquire businesses, we allocate the purchase price to tangible assets and liabilities and identifiable intangible assets acquired. Any residual purchase price is recorded as goodwill. The allocation of the purchase price requires management to make significant estimates in determining the fair values of assets acquired and liabilities assumed, especially with respect to intangible assets. These estimates are based on historical experience and information obtained from the management of the acquired companies. These estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future, the appropriate weighted-average cost of capital, and the synergistic benefits expected to be derived from the acquired business. These estimates are inherently uncertain and unpredictable. In addition, unanticipated events and circumstances may occur which may affect the accuracy or validity of such estimates.

Goodwill. We record goodwill when the consideration paid for an acquisition exceeds the fair value of net tangible and intangible assets acquired. We measure and test goodwill on an annual basis or more frequently if

we believe indicators of impairment exist. Our impairment review process compares the fair value of the reporting unit in which the goodwill resides to its carrying value. We determined that our reporting units are equivalent to our operating segments or components of an operating segment for the purposes of completing our impairment test. Prior to fiscal 2017, we utilize a two-step approach to testing goodwill for impairment. The first step tests for possible impairment by applying a fair value-based test. In computing fair value of our reporting units, we use estimates of future revenues, costs and cash flows from such units. The second step, if necessary, measures the amount of such impairment by comparing the implied fair value of goodwill to its carrying value. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized equal to that excess. In the fourth quarter of 2017, we elected to early adopt FASB Accounting Standard Update 2017-04, which removed step two from goodwill impairment test, in conjunction with our annual review for impairment. Estimating fair value is performed by utilizing various valuation approaches, such as income approach or market approach. The total of all reporting unit fair values was also compared to our market capitalization plus control premium for reasonableness.

In 2016, no impairment charges were recorded. In 2017 and 2018, we recorded an impairment charge of US\$10.3 million and US\$0.6 million because the carrying value of the mobile communication reporting unit and software defined storage unit, exceeded its fair value. The impairment charge was mainly attributable to a new project cancellation by a customer and delayed commercialization of a new product in 2017 and low achievement rate of revenue projection in 2018, respectively. The estimate of cash flow was based upon, among other things, certain assumptions about expected future operating performance such as revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, and determination of appropriate market comparables. We based our fair value estimates on assumptions we believed to be reasonable but that are unpredictable and inherently uncertain. The long-term financial forecast represented the best estimate that we had at that time and we believed that its underlying assumptions were reasonable. However, actual performance in the near-term and longer-term could be materially different from the forecast, which could impact future estimates of fair value of our reporting units and may result in a charge to earnings in future periods due to the potential for further write-down of goodwill in connection with future impairment tests.

Accounting for income taxes. In preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. We are tax resident in numerous taxing jurisdictions around the world and have identified our major tax jurisdictions as Taiwan, Hong Kong, Korea, Macau and China with statutory tax rate of 20%, 16.5%, 11%, 12% and 25%, respectively. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income within the relevant jurisdiction and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. The total amount of valuation allowance as of December 31, 2016, 2017 and 2018 was US\$20.8 million, US\$19.1 million and US\$20.0 million, respectively. We provide for a valuation allowance to the extent we believe that it is more likely than not that the deferred tax assets will not be recovered from future taxable income. Realization of the future tax benefits related to the deferred tax assets is dependent on many factors, including our ability to generate taxable income within the period during which the temporary differences reverse, the outlook for the economic environment in which we operate, and the overall future industry outlook. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an additional allowance for the deferred tax asset would be charged to income in the period the determination was made.

We utilize a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The total amount of unrecognized tax benefits as of

December 31, 2016, 2017 and 2018 was US\$10.3 million, US\$15.1 million and US\$18.7 million, respectively. As of December 31, 2017 and 2018, US\$3.4 million and US\$4.1 million, respectively, of interest and penalties were accrued. Fiscal years 2013 through 2018 remain subject to examination by the US Internal Revenue Service and other foreign tax jurisdictions. The ultimate outcome of tax matters may differ from our estimates and assumptions. Unfavorable settlement of any particular issue would require the use of cash and could result in increased income tax expense. Favorable resolution could result in reduced income tax expense. Within the next 12 months, we do not expect that our unrecognized tax benefits would change significantly. See Note 16 to the Consolidated Financial Statements for further information regarding changes in unrecognized tax benefits during 2018.

Legal Contingencies. From time to time, we are involved in legal actions or other third-party assertions arising in the ordinary course of business. There can be no assurance these actions or other third-party assertions will be resolved without costly litigation, in a manner that does not adversely impact our financial position, results of operations or cash flows or without requiring royalty payments in the future, which may adversely impact gross margins. We record a liability when it is probable that a loss has been incurred and the amount can be reasonably estimated. In determining the probability of a loss and consequently, determining a reasonable estimate, management is required to use significant judgment. Given the uncertainties associated with any litigation, the actual outcome can be different than our estimates and could adversely affect our results of operations, financial position and cash flows. See Item 8: “Legal Proceedings”.

Results of Operations

The following table sets forth our statements of operations as a percentage of net sales for the periods indicated:

	Year Ended December 31,		
	2016	2017	2018
Net sales	100.0%	100.0%	100.0%
Cost of sales	50.6	52.0	50.8
Gross profit	49.4	48.0	49.2
Operating expenses:			
Research and development	16.6	19.5	19.2
Sales and marketing	4.6	4.9	5.5
General and administrative	3.1	3.2	3.3
Impairment of goodwill and intangible assets	—	2.0	0.8
Amortization of intangible assets	0.4	0.5	0.6
Gain from disposal of noncurrent assets held for sale	—	(0.4)	—
Total operating expenses	24.7	29.7	29.4
Operating income	24.7	18.3	19.8
Non-operating income (expenses):			
Gain from disposal of short-term investments	0.0	0.0	0.0
Interest income	0.3	0.8	1.2
Foreign exchange gain (loss), net	(0.1)	(0.0)	(0.1)
Impairment of long-term investments	(0.0)	(0.0)	—
Interest expense	(0.0)	(0.1)	(0.1)
Loss on equity-method investment	—	—	(0.1)
Other income (loss), net	0.0	(0.0)	0.0
Total non-operating income	0.2	0.7	0.9
Income before income taxes	24.9	19.0	20.7
Income tax expense	5.0	4.6	2.2
Net income	19.9%	14.4%	18.5%

Comparison of Year Ended December 31, 2018 to Year Ended December 31, 2017

Net sales.

	Years Ended December 31					
	2017		2018		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Net sales						
Mobile Storage	480,735	92	494,012	93	13,277	3
Mobile Communications	37,447	7	30,163	6	(7,284)	(19)
Others	5,222	1	6,173	1	951	18
Net sales	523,404	100	530,348	100	6,944	1

In 2018, our net sales increased by 1% year-over-year to approximately US\$530.3 million, primarily the result of SSD controller sales increasing by about 30%, partially offset by eMMC plus UFS controller sales decreasing by about 10% and SSD solutions sales decreasing by about 5%.

Our Mobile Storage revenue increased by 3% year-over-year and Mobile Communications revenue decreased by 19%.

Gross profit.

	Years Ended December 31					
	2017		2018		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Gross profit	251,194	48	260,807	49	9,613	4

Gross profit increased to 49% of net sales in 2018 as compared to 48% in 2017 primarily because of increasing sales of higher gross margin controllers and declining sales of lower gross margin SSD solutions. Our gross profit excluding obsolete and unmarketable inventory write-downs as a percentage of revenue increased from 48% in 2017 to 50% in 2018.

Research and development expenses.

	Years Ended December 31					
	2017		2018		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Salary and benefits	54,019	10	53,922	10	(97)	0
Stock-based compensation	9,255	2	13,278	2	4,023	43
Other research and development	38,779	8	34,828	7	(3,951)	(10)
Research and development	102,053	20	102,028	19	(25)	0

Our research and development expenses were stable year-over-year at approximately US\$102.0 million in 2018. Salary and benefits were stable year-over-year at approximately US\$53.9 million in 2018. Stock-based compensation increased by 43% year-over-year to approximately US\$13.3 million. Other research and development expenses decreased by 10% year-over-year to approximately US\$34.8 million, primarily because of less IC tape-outs and other project expenses in 2018.

Sales and marketing expenses.

	Years Ended December 31					
	2017		2018		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Salary and benefits	14,425	3	15,546	3	1,121	8
Stock-based compensation	3,167	1	3,407	1	240	8
Other sales and marketing	8,276	1	10,326	2	2,050	25
Sales and marketing	25,868	5	29,279	6	3,411	13

Our sales and marketing expenses increased by 13% year-over-year to approximately US\$29.3 million in 2018. Salary and benefits increased by 8% year-over-year to approximately US\$15.5 million, primarily because of more headcounts in 2018. Stock-based compensation increased by 8% year-over-year to approximately US\$3.4 million in 2018. Other sales and marketing expenses increased by 25% year-over-year to approximately US\$10.3 million primarily because of large expenditures for technical services and samples in 2018.

General and administrative expenses.

	Years Ended December 31					
	2017		2018		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Salary and benefits	9,386	2	8,073	1	(1,313)	(14)
Stock-based compensation	2,779	—	3,704	1	925	33
Other general and administrative	4,768	1	5,856	1	1,088	23
General and administrative	16,933	3	17,633	3	700	4

Our general and administrative expenses increased by 4% year-over-year to approximately US\$17.6 million in 2018. Salary and benefits decreased by 14% year-over-year to approximately US\$8.1 million, primarily because of lower bonus payments in 2018. Stock-based compensation increased by 33% year-over-year to approximately US\$3.7 million in 2018. Other general and administrative expenses increased by 23% year-over-year to approximately US\$5.9 million primarily because of more professional service fees and bad debt expense accruals in 2018.

Stock-based compensation.

The following table presents details of total stock-based compensation expense that is included in each functional line item in our consolidated statements of income:

	Years Ended December 31					
	2017		2018		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Cost of sales	293	—	390	—	97	33
Research and development	9,255	2	13,278	2	4,023	43
Sales and marketing	3,167	1	3,407	1	240	8
General and administrative	2,779	—	3,704	1	925	33
Total stock-based compensation	15,494	3	20,779	4	5,285	34

Total stock-based compensation, all of which are RSU expenses, increased by 34% in 2018.

See Note 18 to Consolidated Financial Statements for a discussion of activity related to share-based awards.

Impairment of goodwill and intangible assets. We performed annual impairment assessments of the carrying value of goodwill and intangible assets in November 2017 and 2018. During our 2017 assessment, we compared the carrying value of FCI to its estimated fair value and determined that goodwill and intangible assets were impaired and recognized approximately US\$10.3 million for impairment of goodwill. During our 2018 assessment, we compared the carrying value of Bigtera to its estimate fair value and determined that goodwill was impaired and recognized approximately \$4.1 million for impairment of goodwill and intangible assets.

Amortization of intangible assets.

	Years Ended December 31					
	2017		2018		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Amortization of intangible assets	2,534	—	2,964	—	430	17

Our amortization of intangible asset increased by 17% year-over-year to approximately US\$3.0 million because of our acquisition of Bigtera in July 2017.

Gain (loss) from disposal of noncurrent assets held for sale. In 2017, we sold an office space located in Shanghai, China and recognized a gain from disposal of US\$1.9 million.

Gain from disposal of short-term investments. We realized gains on sales of trading securities of US\$103 thousand and US\$134 thousand for the years ended December 31, 2017 and 2018, respectively.

Interest income. Our interest income increased to approximately US\$6.3 million for the year ended December 31, 2018 from approximately US\$4.3 million for the year ended December 31, 2017.

Impairment of long-term investment. In 2017, we recognized impairment charges for our investments in Cashido and Vastview because a combination of recurring losses and reduced forecasts indicated that our investments were not recoverable within a reasonable period of time and the impairments were other than temporary and recorded a combined impairment charge of US\$120 thousand.

Interest expense. Interest expense decreased to approximately US\$378 thousand for the year ended December 31, 2018 from approximately US\$423 thousand for the year ended December 31, 2017 because we repaid a bank loan before the end of the year.

Foreign exchange gain (loss), net. For the year ended December 31, 2018, we incurred foreign exchange losses of US\$615 thousand, compared with losses of US\$157 thousand for the year ended December 31, 2017. We do not engage in any hedging activities.

Income tax expense (benefit). Income tax expense was approximately US\$11.8 million for the year ended December 31, 2018 compared to an income tax expense of approximately US\$24.0 million for the year ended December 31, 2017.

Net income (loss). Net income was approximately US\$98.1 million for the year ended December 31, 2018 compared to a net income of approximately US\$75.0 million for the year ended December 31, 2017.

Comparison of Year Ended December 31, 2017 to Year Ended December 31, 2016

Net sales.

	Years Ended December 31				\$ change	% change
	2016		2017			
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Net sales						
Mobile Storage	510,687	92	480,735	92	(29,952)	(6)
Mobile Communications	39,322	7	37,447	7	(1,875)	(5)
Others	6,137	1	5,222	1	(915)	(15)
Net sales	556,146	100	523,404	100	(32,742)	(6)

Our net sales decreased by 6% year-over-year to approximately US\$523.4 million in 2017, primarily because of decreasing sales of products to the mobile storage market.

Our Mobile Storage revenue decreased by 6% year-over-year primarily because of increasing sales of SSD solutions more than offset by declining eMMC, SSD and expandable storage controller sales. Mobile Communications revenue decreased by 5% primarily because increasing sales of mobile TV SoCs were more than offset by declining sales of CDMA transceivers, which have reached obsolescence.

Gross profit.

	Years Ended December 31					
	2016		2017		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Gross profit	274,605	49	251,194	48	(23,411)	(9)

Gross profit as a percentage of net sales decreased to 48% in 2017 as compared to 49% in 2016 primarily because of increasing sales of lower gross margin SSD solutions and declining sales of higher gross margin SSD controllers. Our gross profit excluding obsolete and unmarketable inventory write-downs as a percentage of revenue decreased from 50% in 2016 to 48% in 2017.

Research and development expenses.

	Years Ended December 31					
	2016		2017		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Salary and benefits	50,925	9	54,019	10	3,094	6
Stock-based compensation	10,529	2	9,255	2	(1,274)	(12)
Other research and development	30,951	6	38,779	8	7,828	25
Research and development	92,405	17	102,053	20	9,648	10

Our research and development expenses increased by 10% year-over-year to approximately US\$102.1 million in 2017. Salary and benefits increased by 6% year-over-year to approximately US\$54.0 million, primarily because of more headcounts in 2017. Stock-based compensation decreased by 12% year-over-year to approximately US\$9.3 million. Other research and development expenses increased by 25% year-over-year to approximately US\$38.8 million, primarily because of higher IC tape-out and other project expenses in 2017.

Sales and marketing expenses.

	Years Ended December 31					
	2016		2017		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Salary and benefits	15,100	3	14,425	3	(675)	(4)
Stock-based compensation	3,122	1	3,167	1	45	1
Other sales and marketing	7,543	1	8,276	1	733	10
Sales and marketing	25,765	5	25,868	5	103	0

Our sales and marketing expenses were unchanged year-over-year at approximately US\$25.9 million in 2017. Salary and benefits decreased by 4% year-over-year to approximately US\$14.4 million, primarily because of lower bonus payments in 2017. Stock-based compensation increased by 1% year-over-year to approximately US\$3.2 million in 2017. Other sales and marketing expenses increased by 10% year-over-year to approximately US\$8.3 million primarily because of more product testing fees in 2017.

General and administrative expenses.

	Years Ended December 31					
	2016		2017		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Salary and benefits	9,184	2	9,386	2	202	2
Stock-based compensation	3,313	—	2,779	—	(534)	(16)
Other general and administrative	4,575	1	4,768	1	193	4
General and administrative	17,072	3	16,933	3	(139)	(1)

Our general and administrative expenses decreased by 1% year-over-year to approximately US\$16.9 million in 2017. Salary and benefits increased by 2% year-over-year to approximately US\$9.4 million, primarily because of more headcount in 2017. Stock-based compensation decreased by 16% year-over-year to approximately US\$2.8 million in 2017. Other general and administrative expenses increased by 4% year-over-year to approximately US\$4.8 million primarily because of more professional service fees in 2017.

Stock-based compensation.

The following table presents details of total stock-based compensation expense that is included in each functional line item in our consolidated statements of income:

	Years Ended December 31					
	2016		2017		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Cost of sales	400	—	293	—	(107)	(27)
Research and development	10,529	2	9,255	2	(1,274)	(12)
Sales and marketing	3,122	1	3,167	1	45	1
General and administrative	3,313	—	2,779	—	(534)	(16)
Total stock-based compensation	17,364	3	15,494	3	(1,870)	(11)

Total stock-based compensation, all of which are RSU expenses, decreased by 11% in 2017.

See Note 18 to Consolidated Financial Statements for a discussion of activity related to share-based awards.

Impairment of goodwill and intangible assets. We performed annual impairment assessments of the carrying value of goodwill in November 2016 and 2017. No impairment was recognized in 2016. During our 2017 evaluation, we compared the carrying value of FCI to its estimated fair value and determined that goodwill was impaired and recognized approximately US\$10.3 million for goodwill impairment.

Amortization of intangible assets.

	Years Ended December 31					
	2016		2017		\$ change	% change
	US\$	% of net sales	US\$	% of net sales		
	(in thousands, except percentage data)					
Amortization of intangible assets	2,103	—	2,534	—	431	20

Our amortization of intangible asset increased by 20% year-over-year to approximately US\$2.5 million because of our acquisition of Bigtera in July 2017.

Gain (loss) from disposal of noncurrent assets held for sale. In 2017, we sold an office space located in Shanghai, China and recognized a gain from disposal of US\$1.9 million.

Gain from disposal of short-term investments. We realized gains on sales of the trading securities of US\$2 thousand and US\$103 thousand for the years ended December 31, 2016 and 2017, respectively.

Interest income. Our interest income increased to approximately US\$4.3 million for the year ended December 31, 2017 from approximately US\$2.2 million for the year ended December 31, 2016.

Impairment of long-term investment. In 2016 and 2017, we determined that our investments in Cashido and Vastview were impaired because a combination of recurring losses and reduced forecasts indicated that our investments were not recoverable within a reasonable period of time and that the impairments were other than temporary and recorded a combined impairment charge of US\$13 thousand and US\$120 thousand, respectively.

Interest expense. Interest expense increased to approximately US\$423 thousand for the year ended December 31, 2017 from approximately US\$127 thousand for the year ended December 31, 2016 because of greater use of bank credit facilities.

Foreign exchange gain (loss), net. For the year ended December 31, 2017, we incurred foreign exchange losses of US\$157 thousand, compared with losses of US\$692 thousand for the year ended December 31, 2016. We do not engage in any hedging activities.

Income tax expense (benefit). Income tax expense was approximately US\$24.0 million for the year ended December 31, 2017 compared to an income tax expense of approximately US\$27.7 million for the year ended December 31, 2016.

Net income (loss). Net income was approximately US\$75.0 million for the year ended December 31, 2017 compared to a net income of approximately US\$110.9 million for the year ended December 31, 2016.

Liquidity and Capital Resources

	Year Ended December 31	
	2017	2018
	US\$	US\$
	(in thousands)	
Cash and cash equivalents	359,453	284,989
Short-term investments	6,941	3,609
Cash, cash equivalents and short-term investments	366,394	288,598

As of December 31, 2018, we had approximately US\$288.6 million in cash, cash equivalents and short-term investments, a decrease of \$77.8 million from December 31, 2017. We maintain our cash balances in bank deposits and in money market instruments. We do not engage in any currency hedging activities. Our short-term investments consist primarily of principal protected notes that we trade.

We believe our existing cash balances and short-term investments, together with cash we expect to generate from operating activities, will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including the level of our net sales, the timing and extent of spending to support product development efforts, the expansion of sales and marketing activities, the timing of introductions of new products, the costs to ensure access to adequate manufacturing capacity, the continuing market acceptance of our products, availability of attractive acquisition and investment opportunities, dividend payments, share repurchases and construction of our office building. We could be required, or could elect, to seek additional funding through public or private equity or debt financing, and additional funds may not be available on terms acceptable to us or at all.

The following table sets forth a summary of our cash flows for the periods indicated:

	Year Ended December 31,		
	2016	2017	2018
	US\$	US\$	US\$
	(in thousands)		
Consolidated Cash Flow Data:			
Net cash provided by operating activities	125,568	103,881	108,242
Net cash used in investing activities ⁽¹⁾	(8,220)	(14,548)	(79,568)
Net cash provided by (used in) financing activities	2,194	(31,740)	(101,820)
Depreciation and amortization	11,585	13,133	14,796
Capital expenditures	(12,220)	(11,683)	(74,853)

Operating activities

Our net cash provided by operating activities was approximately US\$108.2 million for the year ended December 31, 2018, compared to net cash provided by operating activities of approximately US\$103.9 million and US\$125.6 million during 2017 and 2016, respectively.

For the year ended December 31, 2018, cash flow provided by operations of US\$108.2 million resulted primarily from our net income of US\$98.1 million and the following reasons:

- Our net income includes substantial non-cash charges, namely US\$14.8 million of depreciation and amortization, US\$20.8 million of stock-based compensation and US\$4.1 million of impairment of goodwill and intangible assets.
- Net working capital increased by US\$31.5 million. Inventory decreased by US\$12.7 million, notes and accounts receivable increased by US\$12.6 million, notes and accounts payable decreased by US\$28.8 million, income tax payable decreased by US\$7.3 million, and other assets net of other liabilities provided US\$4.6 million of cash.

For the year ended December 31, 2017, cash flow provided by operations of US\$103.9 million resulted primarily from our net income of US\$75.0 million and the following reasons:

- Our net income includes substantial non-cash charges, namely US\$13.1 million of depreciation and amortization and US\$15.5 million of stock-based compensation and US\$10.3 million of impairment of goodwill and intangible assets..
- Net working capital increased by US\$5.6 million. Inventory increased by US\$22.3 million, notes and accounts receivable increased by US\$5.2 million, notes and accounts payable increased by US\$24.2 million, income tax payable decreased by US\$8.7 million, and other assets net of other liabilities provided US\$6.4 million of cash.

Investing activities

Our net cash used in investing activities was approximately US\$79.6 million for the year ended December 31, 2018, compared to net cash used in investing activities of approximately US\$14.5 million for the year ended December 31, 2017. In 2018, we paid US\$9.7 million for the routine purchase of software, design tools and other items, US\$58.9 million for the purchase of land for our future Taiwan headquarters building and US\$4.7 million for purchase of a long-term investment.

Our net cash used in investing activities was approximately US\$14.5 million for the year ended December 31, 2017, compared to net cash used in investing activities of approximately US\$8.2 million for the year ended December 31, 2016. In 2017, we paid US\$11.7 million for the routine purchase of software, design tools and other items and US\$2.9 million to acquire Bigtera.

Financing activities

Our net cash used in financing activities was approximately US\$101.8 million for the year ended December 31, 2018, compared to net cash provided by financing activities of approximately US\$31.7 million for the year ended December 31, 2017. Our cash used in financing activities in 2018 consists primarily of US\$43.3 million of dividend payments, US\$33.5 million for share repurchases and US\$25 million for repayment of a bank loan.

Our net cash used in financing activities was approximately US\$31.7 million for the year ended December 31, 2017, compared to net cash provided by financing activities of approximately US\$2.2 million for the year ended December 31, 2016. Our cash used in financing activities in 2017 consists primarily of US\$32.1 million of dividend payments.

Capital Return to Shareholders

Dividend. On October 29, 2018, we announced an annual cash dividend of \$1.20 per ADS to be paid in four quarterly installments of \$0.30 per ADS, which succeeds our previous \$1.20 per ADS annual cash dividend. In accordance with our dividend declarations, we paid \$32.1 million and \$43.3 million to shareholders in 2017 and 2018, respectively.

The declaration and payment of future cash dividends are subject to our Board's continuing determination that the payment of dividends are in the best interests of our shareholders and are in compliance with all laws and agreements applicable to the declaration and payment of cash dividends.

Share Repurchase. On November 21, 2018, we announced a new share repurchase program to repurchase up to \$200 million of our ADSs over a 24 month period. On August 1, 2017, we announced a share repurchase program to repurchase up to \$200 million of our ADSs over a 12 month period. In 2017, we repurchased zero ADSs, and in 2018 we repurchased 1.0 million ADSs for \$34.8 million at an average price of \$34.52 per ADS.

Repurchases will be made in the open market or according to other methods in compliance with Securities and Exchange Commission Rule 10b-18, subject to market conditions, applicable legal requirements and other factors. Share repurchase plans announced does not obligate us to acquire any particular amount of ADS and may be suspended at any time at our discretion.

Contractual Obligations

The following table sets forth our commitments to settle contractual obligations in cash as of December 31, 2018:

	Amount of Commitment Maturing by Year				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	US\$	US\$	US\$	US\$	US\$
	(in thousands)				
Operating leases	5,887	2,802	3,020	65	—
Capital leases	—	—	—	—	—
Pension	1,900	1,900	(a)	(a)	(a)
Long-term payable	319	319	—	—	—
Other long term liabilities	6,212	477	5,735	—	—
Contractual cash obligations	<u>14,318</u>	<u>5,498</u>	<u>8,755</u>	<u>65</u>	<u>—</u>

(a) Our pension obligation after one year has not been estimated.

We increased long-term taxes payable of US\$3,652 thousand related to uncertain tax positions as of December 31, 2018. At this time, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing and outcome of a potential tax audit.

Off-balance Sheet Arrangements

We currently do not have any outstanding derivative financial instruments, off-balance sheet guarantees or arrangements, interest rate swap transactions, or foreign currency forward contracts. We do not engage in any trading activities involving non-exchange traded contracts.

Recent Accounting Pronouncements

Please refer to Note 2 to the consolidated financial statements

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Executive Officers and Directors

Members of our board of directors are elected by our shareholders. Our board of directors consists of seven directors.

Our executive officers are appointed by, and serve at the discretion of, our board of directors. The following table sets forth information regarding our directors and executive officers as of the date of this annual report.

<u>Name</u>	<u>Age</u>	<u>Position</u>
James Chow	68	Chairman of the Board
Wallace C. Kou	60	President, Chief Executive Officer and Managing Director
Steve Chen	47	Director
Tsung-Ming Chung	69	Director
Lien-Chun Liu	61	Director
Yung-Chien Wang	56	Director
Han-Ping D. Shieh	65	Director
Kenneth Kuan-Ming Lin	66	Director
Riyadh Lai	50	Chief Financial Officer
Nelson Duann	50	Senior VP of Marketing & R&D, Mobile Storage and Director
Sangwoo Han	50	Senior VP and General Manager, Mobile Communications
Xueshi Yang	42	Senior VP and General Manager, Shannon Systems
Arthur Yeh	58	VP of Sales, Mobile Storage
Robert Fan	55	President of SMI USA
John (Chun-O) Kim	58	VP of Sales, Mobile Communications
David Yu	44	VP of Sales & Marketing, Shannon Systems
Leander Yu	44	VP of Sales & Marketing, Bigtera
Ken Chen	57	VP of Operations
Kevin Yeh	55	VP of R&D, Algorithm & Technology
John (Jong Ryul) Lee	55	VP of R&D, Mobile Communications
Derek Zhou	42	VP of R&D, Shannon Systems
Frank Shu	62	VP of R&D, Verification Engineering & Compatibility Test
Mike Jing	59	VP of IT

Executive Officers and Directors

James Chow, Chairman of the Board of Directors

Mr. Chow has served as the Chairman of our board of directors since April 2005. Mr. Chow has been the Chairman of Concord Financial Co., Ltd. since 1993. Concord Financial Co., Ltd. is an investment holding company and was one of our significant shareholders. Mr. Chow has an MBA from Columbia University.

Wallace C. Kou, President, Chief Executive Officer, Managing Director

Mr. Kou founded Silicon Motion in 1995 and has been our President and Chief Executive Officer since our founding. Prior to founding Silicon Motion, Mr. Kou was the Vice President and Chief Architect at the Multimedia Products Division of Western Digital Corporation, which developed graphics processors for notebook PCs and was sold to Philips Semiconductor in 1995. Before Western Digital, Mr. Kou worked for Wyse Technology. Mr. Kou has a BS in Electrical & Control Engineering from the National Chiao Tung University in Taiwan and an MS in Electrical & Computer Engineering from the University of California at Santa Barbara.

Steve Chen, Director

Mr. Chen joined our board of directors in 2012. Mr. Chen is the chairman of Mercuries Co., Ltd.. Mr. Chen has two Master of Engineering degrees from Cornell University.

Tsung-Ming Chung, Director

Mr. Chung joined our board of directors in June 2005. Mr. Chung is the Chairman of Dynapack International Technology Corp, a leading provider of battery packs for notebook PCs and tablets. From 1985 to 2000, Mr. Chung was an audit partner at Arthur Andersen. He is also a director at Far East International Bank and Fubon Hyundai Life Insurance Corporation. Mr. Chung has a BA in Business Administration from the National Taiwan University and an MBA from the National Cheng-chi University in Taiwan.

Lien-Chun Liu, Director

Ms. Liu joined our board of directors in June 2005. She is Vice President of the International Council of Women and currently also serves on the board of supervisors of Concord VIII Venture Capital Co., Ltd. and the board of directors of New Tamsui Golf Course. She was formerly a research fellow at the Taiwan Research Institute and served on the board of supervisors of China Television Corp. from 2000 to 2004. Ms. Liu has a BA from Wellesley College and a JD from Boston College Law School.

Yung-Chien Wang, Director

Mr. Wang joined our board of directors in June 2005. Mr. Wang has over 20 years of working experience in the human resource and legal services industries. Mr. Wang has been a consultant of Professional Trust Co., Ltd., a human resource consulting firm in Taiwan since August 1998 and is currently its Vice President. Mr. Wang has a law degree from Fu Jen Catholic University in Taiwan.

Han-Ping D. Shieh, Director

Mr. Shieh joined our board of directors in 2014. He is a Chair Professor at National Chiao Tung University (NCTU) in Taiwan, a fellow of the Institute of Electrical and Electronics Engineers, The Optical Society and the Society for Information Display and a board member of Young Optics Inc. and Focal Tech. Inc. Mr. Shieh received his PhD in Electrical and Computer Engineering from Carnegie Mellon University in 1987. He joined NCTU as a professor in 1992 and was previously a Research Staff Member at the IBM Thomas J. Watson Research Center. He was previously the Dean of the College of Electrical and Computer Engineering, Senior Vice President at NCTU and Vice Chancellor at the University of Taiwan.

Kenneth Kuan-Ming Lin, Director

Mr. Lin joined our board of directors in September 2018. Mr. Lin was previously a director on our board between September 2009 and September 2014. Mr. Lin is the Chairman of Premier Capital Management Corp., Ruby Tech Corp. and Taiwan Health Care Association, Chief Executive Officer of SINOCON Industrial Standards Foundation, and Deputy Secretary-General of Cross-Strait CEO Summit. He was previously the Chairman of the Taiwan Venture Capital Association and the Taiwan Private Equity Association and a Board Director of the Straits Economic & Cultural Interchange Association. Mr. Lin has a BS in Electrical Engineering from the National Taiwan University.

Riyadh Lai, Chief Financial Officer

Mr. Lai joined us in April 2007 from ING Corporate Finance, Asia, where he was the Head of the Technology Group. Previously, he was also an investment banker at Morgan Stanley and ABN AMRO and finance manager at PepsiCo in Hong Kong and New York. Mr. Lai has over two decades of finance and financial management experience. He has a BA in Economics from Georgetown University and an MBA from New York University.

Nelson Duann, Senior VP of Marketing and R&D, Mobile Storage and Director

Mr. Duann became our Senior Vice President of marketing and R&D for mobile storage in November 2018. He joined Silicon Motion in August 2007 as a product marketing director and R&D team leader. Mr. Duann has almost 20 years of experience in the semiconductor industry in product design, development and marketing. Prior to Silicon Motion, he worked for Sun Microsystems Inc., focusing on UltraSPARC microprocessor projects. He has an MS in Communications Engineering from National Chiao Tung University in Taiwan and an MS in Electrical Engineering from Stanford University.

Sangwoo Han, Senior VP and General Manager, Mobile Communications

Mr. Han became the General Manager of our Mobile Communications product line in July 2008. He was formerly the Chief Technology Officer at FCI, a company that we acquired in April 2007. Mr. Han joined FCI in 2003 and had been in charge of product design, development, production and marketing. In 1997, he co-founded RF Solutions Inc. in Atlanta, Georgia, which became the Anadigics Wireless LAN Center of Excellence. Mr. Han has a BS in Electrical Engineering from Carnegie-Mellon University, an MS in Electrical Engineering from the University of Pennsylvania, and a PhD in Electrical Engineering from the Georgia Institute of Technology.

Xueshi Yang, Senior VP and General Manager, Shannon Systems

Mr. Yang joined us in July 2015 as General Manager of Shannon Systems, our enterprise SSD product line, following our acquisition of this business. He co-founded Shannon Systems in 2011 and as CEO, led the development and commercialization of enterprise-grade PCIe SSDs that were the industry's first in terms of storage capacity and scalability, ultra-low latency and low-power envelope. Prior to Shannon, Mr. Yang was the chief architect at Marvell of its first generations of SSD controllers, a research staff at Seagate and postdoctoral researcher at Princeton University. He holds a PhD in Electrical Engineering from Drexel University and a BS in Electrical Engineering from Tsinghua University in China. Mr. Yang has more than 100 US patents granted or pending relating to SSDs.

Arthur Yeh, VP of Sales, Mobile Storage

Mr. Yeh has served as our Vice President in charge of our mobile storage sales since November 2004. Mr. Yeh has over 20 years of sales experience managing marketing strategies, including product promotions and

sales activities for semiconductor products. Mr. Yeh previously served in management positions at VIA Technologies for 10 years and joined us in 2004. Mr. Yeh holds an MS degree in Management Business Administration from the National Chung Hsing University, in Taiwan.

Robert Fan, President of SMI USA

Mr. Fan has served as President of SMI USA in charge of Silicon Motion's business operations in the Americas and Europe since November 2016. He also oversees corporate marcom and PR efforts as well as the graphics business. Mr. Fan has over 25 years of sales and marketing experience and joined Silicon Motion in May 2013 as Vice President and General Manager of SMI USA. Prior to Silicon Motion, Mr. Fan served in executive management roles at Spansion, IDT, Staktek, Berkana Wireless (acquired by Qualcomm) and Resonext (acquired by RF Micro Devices). He also spent over nine years at Intel in sales, marketing and management positions. Mr. Fan holds a BS in Electrical Engineering from the University of California, Berkeley and MSEE from Santa Clara University, and completed the General Management Executive Program at McCombs School of Business, University of Texas.

John (Chun-O) Kim, VP of Sales, Mobile Communications

Mr. Kim became the Vice President of our Mobile Communications product line in July 2008. He was formerly the Vice President of Sales at FCI, a company that we acquired in April 2007. Mr. Kim joined FCI in 2006 and had previously served in management positions at Hewlett-Packard's semiconductor division (which became Avago Technologies) and as a CEO of a private company. Mr. Kim has over 16 years of semiconductor sales leadership experience, including managing marketing strategies, product promotions and sales activities. He has an MS in Electrical Engineering from Ajou University in Korea.

David Yu, VP of Sales & Marketing, Shannon Systems

Mr. Yu joined us in July 2015 as Vice President of Sales & Marketing of Shannon Systems, our enterprise SSD product line, following our acquisition of this business. He joined Shannon Systems in 2014 and has been instrumental in managing its rapid sales growth. Previously and for over 10 years, he held sales leadership positions at Infineon and RF Micro Devices in China. He holds an MS in Management from the University of Ottawa and a BS in Electrical Engineering from Tsinghua University in China.

Leander Yu, VP of Sales & Marketing, Bigtera

Mr. Yu joined us in July 2017 as Vice President of Sales and Marketing of Bigtera, our software-defined storage (SDS) product line, following our acquisition of this business. He founded Bigtera in 2012 to provide enterprise-class SDS to the Greater China market. Prior to Bigtera, Mr. Yu was a senior architect at Trend Micro and its subsidiary TCloud Computing and responsible for the design of software solutions including cloud storage products. He has a BS in Computer Science and Information Engineering from National Taiwan University.

Ken Chen, VP of Operations

Mr. Chen has served as our Vice President in charge of operations since November 2003. Mr. Chen has over 20 years of manufacturing and operations experience in the semiconductor industry, managing supply chain and virtual manufacturing systems including wafer fabrication, mask tooling, as well as assembly and testing. Mr. Chen previously served in management positions at Faraday Technology and UMC, and joined us in 2003. Mr. Chen has a BS in Industrial Engineering from Chung Yuan Christian University in Taiwan and an MS in Industrial Engineering and Engineering Management from the National Tsing Hua University, Taiwan.

Kevin Yeh, VP of R&D, Algorithm & Technology

Mr. Yeh became our Vice President of research and development in August 2012. He joined Silicon Motion in September 2003 as a product marketing director, before leading our Algorithm and Technology R&D team. Mr. Yeh has more than 20 years of experience in semiconductor product design, development and marketing. Prior to Silicon Motion, Mr. Yeh worked in Taiwan Semiconductor Manufacturing Company, Neo Magic, VLSI Technology and LSI. Mr. Yeh holds a BS degree in Control Engineering from National Chiao Tung University in Taiwan and an MS degree in Electronic Engineering from Syracuse University.

John (Jong Ryul) Lee, VP of R&D, Mobile Communications

Mr. Lee became the Vice President of our Mobile Communications product line in July 2008. He was formerly the Vice President of R&D at FCI, a company that we acquired in April 2007. Mr. Lee joined FCI in 2000 and had been in charge of product design, development, production and quality systems. In 2013, he became a director of the Semiconductor & Device Society of The Institute of Electronics Engineers of Korean (IEEK). He was previously a senior engineer at the Electronics and Telecommunications Research Institute (ETRI) in Korea. Mr. Lee has a BS and an MS in Electronics Engineering from Chung Ang University in Korea.

Derek Zhou, VP of R&D, Shannon Systems

Mr. Zhou joined us in July 2015 as Vice President of R&D of Shannon Systems, our enterprise SSD product line, following our acquisition of this business. He co-founded Shannon Systems in 2011 with Mr. Yang and as CTO, managed the development of enterprise-grade PCIe SSDs that were the industry's first in terms of storage capacity and scalability, ultra-low latency and low-power envelope. Prior to Shannon, he was a senior ASIC design engineer with 10 years of experience at Nvidia and Chrontel. He holds an MS in Electrical Engineering from Binghamton University and a BS in Electrical Engineering from Tsinghua University in China.

Frank Shu, VP of R&D, System Validation

Mr. Shu has served as our Vice President of R&D, System Validation since September 2013. He joined us in July 2012 as Vice President of SSD System Technology. Mr. Shu has more than 20 years of experience in the storage and PC system industry. Before joining Silicon Motion, Mr. Shu was the VP of R&D in charge of SSD testing at Allion Labs. Mr. Shu also worked for Microsoft and played a key role in defining and developing the software storage stack for the Windows operating system. Prior to Microsoft, Mr. Shu worked for Fujitsu, Seagate and Everex. Mr. Shu has a BS in Electronic Engineering from Nanjing Aeronautical Institute in China and an MS in Computer Science from the Oregon Graduate Institution of Science & Technology.

Mike Jing, VP of IT

Mr. Jing became our Vice President of IT in August 2016. He joined Silicon Motion in January 2003 and currently leads our IT/MIS team. Prior to Silicon Motion, he worked for Teradyne. Mr. Jing has almost 30 years of experience in software development and IT management and holds a BS and MS in Computer Engineering from the National Chiao Tung University in Taiwan and an MS in Computer Science from the University of California, San Diego.

There is no arrangement or understanding with major shareholders, customers, suppliers or others pursuant to which any person referred to above was selected as a director or member of senior management.

Board Practices

Board Committees

Our board of directors has established an audit committee, a compensation committee, and a nominating and corporate governance committee.

Audit Committee. The audit committee is responsible for reviewing the financial information that will be provided to shareholders and others, reviewing the systems of internal controls that management and the board of directors have established, appointing, retaining and overseeing the performance of independent registered public accounting firms, overseeing our accounting and financial reporting processes and the audits of our financial statements, and pre-approving audit and permissible non-audit services provided by independent registered public accounting firms. Tsung-Ming Chung, Lien-Chun Liu, and Yung-Chien Wang are members of our audit committee. Our board of directors has determined that Mr. Chung, the Chairman of the audit committee, is the committee's "Audit Committee Financial Expert" as required by Nasdaq and U.S. Securities and Exchange Commission ("SEC") rules.

Compensation Committee. The compensation committee's basic responsibility is to review the performance and development of management in achieving corporate goals and objectives and to assure that our senior executives are compensated effectively in a manner consistent with our strategy, competitive practice and the requirements of the appropriate regulatory bodies. Toward that end, this committee oversees, reviews and administers all of our compensation, equity and employee benefit plans and programs. Lien-Chun Liu, Steve Chen, and Yung-Chien Wang are members of our compensation committee, with Mr. Chen serving as the Chairman of the committee.

Nominating and Corporate Governance Committee. The nominating and corporate governance committee is responsible for overseeing, reviewing and making periodic recommendations concerning our corporate governance policies, and for recommending to the full board of directors candidates for election to the board of directors. Lien-Chun Liu, Steve Chen, and Yung-Chien Wang are members of our nominating and corporate governance committee, with Ms. Liu serving as the Chairman of the committee.

Our board of directors has adopted a code of ethics, which is applicable to all of our employees. Our Code of Ethics is posted on our website at www.siliconmotion.com.

Duties of Directors

Under Cayman Islands law, our directors have a duty to act honestly, in good faith and with a view to the best interests of our company. Our directors also have a duty to exercise the care, diligence and skills that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their duty of care to our company, our directors must ensure compliance with our memorandum and articles of association. The functions and powers of our board of directors include, among others:

- convening shareholders' meetings and reporting its work to shareholders at such meetings;
- implementing shareholders' resolutions;
- determining our business plans and investment proposals;
- formulating our profit distribution plans and loss recovery plans;
- determining our debt and finance policies and proposals for the increase or decrease in our registered capital and the issuance of debentures;
- formulating our major acquisition and disposition plans, and plans for merger, division or dissolution;
- proposing amendments to our amended and restated memorandum and articles of association; and
- exercising any other powers conferred by the shareholders' meetings or under our amended and restated memorandum and articles of association.

Terms of Directors and Officers

Under Cayman Islands law and our articles of association, our directors hold office until a successor has been duly elected and qualified. Our articles of association provide that our directors serve for a term of three

years, with one-third of the directors (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) subject to re-election at each annual general meeting of shareholders (chairman and managing director not subject to retirement by rotation nor to be taken into account in determining the number of directors to retire), unless the director was appointed by the board of directors, in which case such director holds office until the next annual meeting of shareholders at which time such director is eligible for re-election. One of our seven directors is currently subject to re-election at our next annual general meeting of shareholders. All of our executive officers are appointed by and serve at the discretion of our board of directors.

Limitation on Liability and Other Indemnification Matters

Cayman Islands law and our articles of association allow us to indemnify our directors, secretary and other officers acting in relation to any of our affairs against actions, costs, charges, losses, damages and expenses incurred by reason of any act done or omitted in the execution of their duties as our directors, secretary and other officers. Under our memorandum and articles of association, indemnification is not available to any matter in respect of any fraud, dishonesty, willful misconduct or bad faith which may attach to any of them.

Compensation of Directors and Executive Officers

For the year ended December 31, 2018, the aggregate compensation to our directors and senior executive officers was approximately US\$ 4.73 million. In 2018, we granted options and restricted stock units to our executive officers as a group to acquire an aggregate of 229,220 ordinary shares. The options and restricted stock units granted to our executive officers and non-executive directors are subject to the same vesting conditions as those of our employees.

Service Contracts

We currently do not have service contracts with our directors.

Share-Based Compensation Plans and Option Grants

In April 2005, our board of directors and shareholders adopted our 2005 Incentive Plan. Our shareholders approved our Amended and Restated 2005 Incentive Plan (referred to in this report as the “2005 Plan”) at our Annual General Meeting in August 2006, including an amendment to increase the authorized number of shares available for issuance under the plan from 10,000,000 shares to 25,000,000 shares. In 2009, the board of directors amended the 2005 Plan to increase the authorized shares available for issuance under the 2005 Plan to 40,000,000 shares. The 2005 Plan expired by its terms on April 22, 2015. On June 3, 2015, the board of directors adopted the 2015 Incentive Plan (the “2015 Plan” and together with the 2005 Plan, the “Plans”). The 2015 Plan reserved 20,000,000 shares of ordinary shares for issuance upon exercise of stock options and restricted stock units. The Plans provide for the grant of stock options, stock bonuses, restricted stock awards, restricted stock units and stock appreciation rights, which may be granted to our employees (including officers), directors and consultants.

Share Reserve. The aggregate number of ordinary shares that may be issued pursuant to awards granted under the 2005 Plan could not exceed 40,000,000 shares and the aggregate number of ordinary shares that may be issued pursuant to awards granted under the 2015 Plan will not exceed 20,000,000, inclusive of ordinary shares issuable upon exercise of awards previously granted under the Silicon Motion, Inc. Guidelines for Issuance and Subscription of Employee Stock Option, which options we have, subject to the consent of the respective option-holders, agreed to assume in the share exchange.

The following types of shares issued under the Plans may again become available for the grant of new awards under the Plans: restricted stock issued under the Plans that is forfeited or repurchased by us prior to it becoming fully vested; shares withheld for taxes; shares tendered to us to pay the exercise price of an option; and shares subject to awards issued under the Plans that have expired or otherwise terminated without having been exercised in full.

Administration. The board of directors will administer the Plans and may delegate this authority to administer the plan to a committee. Subject to the terms of the Plans, the plan administrator, which is our board of directors or its authorized committee, determines recipients, grant dates, the numbers and types of stock awards to be granted and the terms and conditions of the stock awards, including the period of their exercisability and vesting. Subject to certain limitations, the plan administrator will also determine the exercise price of options granted, the purchase price for restricted stock and restricted stock units, and, if applicable, the strike price for stock appreciation rights.

Capitalization adjustments. In the event of a dividend or other distribution (whether in the form of cash, ordinary shares, other securities, or other property), recapitalization, stock split, reorganization, merger, consolidation, exchange of our ordinary shares or our other securities, or other change in our corporate structure, the board of directors may adjust the number and class of shares that may be delivered under the Plans and the number, class and price of the shares covered by each outstanding stock award.

Changes in control. In the event of a change in control of the company, all outstanding options and other awards under the Plans may be assumed, continued or substituted for by any surviving or acquiring entity. If the surviving or acquiring entity elects not to assume, continue or substitute for such awards, the vesting of such awards held by award holders whose service with us or any of our affiliates has not terminated will be accelerated and such awards will be fully vested and exercisable immediately prior to the consummation of such transaction, and the stock awards shall automatically terminate upon consummation of such transaction if not exercised prior to such event.

Amendments to 2005 Plan in 2009 and 2010. In 2009, our board of directors amended the 2005 Plan to (i) increase the authorized shares to 40,000,000 as discussed above and (ii) allow certain unilateral amendments to outstanding options and RSU grants. Shareholder approval for such amendments was not required under Cayman law and we used the home-country exemption for foreign private issuers under Nasdaq rules to effect such amendments without a shareholder vote. In 2009, the Company cancelled 1,221,875 RSUs. There were no changes to outstanding options in 2009. In 2010, the Company exchanged 4,369 thousand stock options for 3,785 thousand new stock options with a similar value.

Future amendments and termination. The board of directors may amend (subject to shareholder approval if required by applicable law), suspend or terminate the 2015 Plan at any time. The 2015 Incentive Plan will terminate pursuant to its terms on June 3, 2025.

Employees

The following table sets forth the number of our employees categorized by function as of the dates indicated.

	As of December 31,		
	2016	2017	2018
Management and administration	121	128	132
Operations	41	42	41
Research and development	767	861	897
Sales and marketing	193	219	237
Total	<u>1,122</u>	<u>1,250</u>	<u>1,307</u>

As of December 31, 2018, we had 1,307 total employees, including 850 in Taiwan, 35 in the United States, 271 in China, 144 in Korea, and 7 in Japan. 1,054 of our total employees are engineers.

We do not have any collective bargaining arrangements with our employees and consider our relations with our employees to be good.

Share Ownership

Under U.S. securities law, a person is deemed to be a “beneficial owner” of a security if that person has or shares “voting power,” which includes the power to vote or to direct the voting of such security, or “investment power,” which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be the beneficial owner of any securities of which that person has a right to acquire beneficial ownership within 60 days. Under these rules, more than one person may be deemed a beneficial owner of securities as to which such person has no economic interest.

There were 146,085,104 of our ordinary shares outstanding as of March 31, 2019. The following table sets forth information with respect to the beneficial ownership of our ordinary shares as of March 31, 2019, less otherwise indicated in the footnotes, by each of our directors and officers:

	Shares Beneficially Owned	
	Number	%
Executive Officers and Directors:		
James Chow ⁽¹⁾	2,361,266	1.62
Wallace C. Kou ⁽²⁾	1,861,248	1.27
Steve Chen	40,000	*
Tsung-Ming Chung	70,000	*
Lien-Chun Liu	224,280	*
Yung-Chien Wang	828,674	*
Han-Ping D. Shieh	49,160	*
Kenneth Kuan-Ming Lin	10,000	*
Riyadh Lai ⁽³⁾	2,090,980	1.43
Nelson Duann	42,000	*
Sangwoo Han	110,408	*
Xueshi Yang ⁽⁴⁾	608,644	*
Arthur Yeh	43,848	*
Robert Fan	52,000	*
John (Chun-O) Kim	43,600	*
David Yu	17,372	*
Ken Chen ⁽⁵⁾	204,049	*
Kevin Yeh	76,200	*
John (Jong Ryul) Lee	23,504	*
Derek Zhou ⁽⁶⁾	349,108	*
Leander Yu	—	*
Frank Shu	49,000	*
Mike Jing	10,700	*

* Less than one percent

- (1) Represents 2,361,266 shares owned by Mr. Chow. Mr. Chow is the chairman of Concord Consulting Inc. and Concord Financial Co. Ltd. which owned 42,445 and 196,491 shares, respectively. Mr. Chow disclaims any beneficial ownership of these shares.
- (2) Represents 1,541,248 shares owned by Mr. Kou, 320,000 shares owned by his family members.
- (3) Represents 1,271,100 shares owned by Mr. Lai and 819,880 shares owned by his spouse.
- (4) Represents 16,000 shares owned by Mr. Yang and 592,644 shares owned by Mr. Yang’s holding company.
- (5) Represents 198,324 shares owned by Mr. Chen and 5,725 shares owned by his spouse.
- (6) Represents 6,000 shares owned by Mr. Zhou and 343,108 shares owned by Mr. Zhou’s holding company.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

As of March 31, 2019, there were 146,085,104 of our ordinary shares outstanding. The Bank of New York Mellon, the depository under our ADS deposit agreement, has advised us that as of March 31, 2019, we had 36,444,370 ADSs, representing 145,777,480 ordinary shares.

The following table sets forth information with respect to the beneficial ownership of more than 5% of our ordinary shares as of March 31, 2019:

<u>Identity of person or group</u>	<u>Number of shares owned</u>	<u>Percentage Owned ⁽¹⁾</u>
Massachusetts Financial Services Company	10,934,092 ⁽²⁾	7.5%
Lazard Asset Management LLC	10,459,832 ⁽³⁾	7.2%
ARGA Investment Management, LP and Avula Rama Krishna.	7,688,452 ⁽⁴⁾	5.3%
Investec Asset Management North America Inc.	7,273,720 ⁽⁵⁾	5.0%

- (1) Based on 146,085,104 ordinary shares outstanding as of March 31, 2019.
- (2) Massachusetts Financial Services Company held 2,733,523 ADSs (representing 10,934,092 ordinary shares) according to a Schedule 13G dated February 13, 2019.
- (3) Lazard Asset Management LLC held 2,614,958 ADSs (representing 10,459,832 ordinary shares), according to a Schedule 13G/A dated February 1, 2019.
- (4) ARGA Investment Management, LP and Avula Rama Krishna held 2,088,771 ADSs (representing 7,688,452 ordinary shares), according to a Schedule 13G dated February 11, 2019.
- (5) Investec Asset Management North America Inc. held 1,818,430 ADSs (representing 7,273,720 ordinary shares) according to a Schedule 13G dated February 14, 2019.

To our knowledge, we are not owned or controlled, directly or indirectly, by another corporation, by any foreign government or by any other natural or legal persons, severally or jointly. We are not aware of any arrangement which may at a later date result in a change of control of our company.

No holder of our ordinary shares has preferential voting rights.

Related Party Transactions

In early 2019, during the due diligence process to sell the Company's FCI subsidiary to Dialog Semiconductor—see “Item 8. “Recent Developments”—it was determined that Jeonse housing leases in Korea were arranged between the lessee, FCI, and lessors, certain FCI employees, including three of our executive officers, or their immediate relatives. These leases, in place from 2007 to 2019, involve the lessee depositing funds equivalent to approximately 80% of the market value of the property interest-free with the lessor in exchange for rent-free housing for the employees. Deposited funds are returned to the lessee in full at the end of the lease period. The total value of the leases in 2016, 2017 and 2018 were \$1.5 million, \$1.6 million and \$1.5 million, of which \$1.1 million, \$1.3 million and \$1.2 million were with executive officers or their immediate relatives, respectively. The Jeonse leases have all been terminated, and the Company intends to complete the sale of FCI in the second quarter, subject to Korean government approvals. The Company intends to take additional steps to improve its internal control structure to reduce the risk of undisclosed related party transactions.

ITEM 8. FINANCIAL INFORMATION

Consolidated Financial Statements

See “Item 18. Financial Statements” and pages F-1 through F-39 of this annual report.

Legal Proceedings

As an active operating company, we are subject to legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. Although the outcome of such proceedings and claims cannot be predicted with certainty, management does not believe that the outcome of any of these matters will have a material adverse effect on our business, results of operations, financial position or cash flows. Any litigation, however, involves potential risk and potentially significant litigation costs, and therefore there can be no assurance that any litigation which is now pending or which may arise in the future would not have such material adverse effect on our business, financial position, results of operations or cash flows.

All American Semiconductor, Inc. (“All American” or “AASI”) was a former distributor for the Company. On April 25, 2007, All American filed for Chapter 11 bankruptcy protection. At the time of the filing, the Company had US\$256 thousand of unpaid accounts receivable from All American. On April 17, 2009 SMI USA and related entities were named as defendants in an adversary proceeding filed by the AASI Creditor Liquidating Trust (“CLT”) in the bankruptcy case pending in the U.S. Bankruptcy Court for the Southern District of Florida. The CLT was seeking the return of allegedly avoidable transfers in the amount of US\$854 thousand. SMI USA filed an answer and affirmative defenses. In March 2010, SMI USA settled with the CLT by paying the amount of US\$220 thousand and on April 1, 2010, the Bankruptcy Court granted the motion to approve stipulations to compromise controversy. On August 23, 2010, the Court entered an order dismissing the adversary proceeding. In June 2011, Liquidating Trustee for the CLT filed the AASI Creditor Liquidating Trustee’s Seventeenth Omnibus Objection to Claims but in August 2011, withdrew it with respect to SMI USA’s proof of claim. As a holder of allowed claims, we are entitled to receive distribution pursuant to the bankruptcy plan. As of December 31, 2017, we received total distributions of US\$265 thousand from the CLT and this case is officially closed.

Significant Changes

No significant changes have occurred since the date of our audited consolidated financial statements.

Recent Developments

a) Sale of FCI

In January 2019, the board of directors of the Company approved the sale of FCI, our specialty RF IC product line for the Mobile Communications market. On March 7, 2019, the Company entered into a definitive agreement with Dialog Semiconductor Plc for the sale of FCI for US\$45 million. The transaction is expected to close in the second quarter of 2019, subject to Korean government approvals.

b) Sale of ProGrade investment

In April 2019, the board of directors approved the sale of the Company’s 49.0% equity interest in ProGrade for \$1.7 million. The sale is expected to close in the second quarter of 2019.

c) Shannon Impairment Risk

In April 2019, key customers of our Shannon SSDs notified the Company that their revised full-year 2019 procurement forecasts will be significantly lower than what they had provided to us in January 2019. As a result, we reduced our Shannon SSD sales forecast to a level meaningfully below what we had planned in January as part of our annual operating plan. The primary reasons of the recently reduced sales forecast include: (i) increasingly risk-adverse customers have reduced procurement plans relating to SSD solutions based on new, less mature technologies such as ours, (ii) weakening economic conditions in China have caused Chinese data center operators to postpone expansion plans and reduce SSD procurement forecasts, including from us, and

(iii) NAND prices have fallen more than we had expected and could fall further, and this will result in less revenue received for the same petabyte of Shannon SSDs that we sell.

The reduced sales forecast represents a triggering event which will require the reevaluation of the reporting unit’s goodwill and intangible assets in the second quarter of 2019. Depending on further development of the situation and factors relevant to a revised financial forecast of the Shannon reporting unit, the impairment assessment may result in impairment of goodwill and of certain intangible assets; however, the Company cannot estimate the amount or a reasonable range of amounts of such impairments, if any, at this time. As of December 31, 2018, the carrying value of the reporting unit’s goodwill was \$33.2 million and intangible assets were \$1.0 million.

ITEM 9. THE OFFER AND LISTING

Market and Share Price Information

Our ADSs, each representing four of our ordinary shares, have been listed on Nasdaq since June 30, 2005. Our ADSs trade under the symbol “SIMO.” The Nasdaq Global Select Market is the principal trading market for our ADSs, which are not listed on any other exchanges in or outside the United States. The high and low sales prices of our ADSs on Nasdaq since 2014 are as follows:

	<u>Price per ADS (US\$)</u>	
	<u>High</u>	<u>Low</u>
Annual:		
2014	28.96	12.92
2015	37.60	20.01
2016	55.85	27.41
2017	55.68	37.37
2018	61.85	31.73
Quarterly:		
First Quarter, 2017	47.33	37.37
Second Quarter, 2017	55.68	44.00
Third Quarter, 2017	49.85	40.33
Fourth Quarter, 2017	55.12	46.50
First Quarter, 2018	56.51	42.57
Second Quarter, 2018	54.62	44.54
Third Quarter, 2018	61.85	47.88
Fourth Quarter, 2018	54.76	31.73
First Quarter, 2019	44.30	32.15
Second Quarter, 2019 ⁽¹⁾	43.08	36.43
Monthly		
November 2018	40.99	31.73
December 2018	38.33	32.16
January 2019	40.37	32.15
February 2019	44.30	38.52
March 2019	42.83	38.06
April 2019	43.08	36.81
May 2019 ⁽¹⁾	42.88	36.43

(1) Through May 14, 2019.

ITEM 10. ADDITIONAL INFORMATION

Memorandum and Articles of Association

The information called for by Item 10B (“Memorandum and Articles of Association”) is incorporated by reference to the information under the heading “Description of Share Capital” in our Registration Statement on Form F-1, as amended (Registration Number 333-125673) and as filed with the SEC on June 5, 2005.

Material Contracts

We have not entered into any material contracts within the past two fiscal years other than in the ordinary course of business and other than those described in Item 4, “Information on the Company” or elsewhere in this annual report.

Exchange Controls

See “Policy on Dividend Distributions” above.

Taxation

United States Federal Income Taxation

The following discussion summarizes certain U.S. federal income tax consequences to a U.S. Holder, as defined below, who purchases our ADSs and ordinary shares. This discussion assumes that investors will hold their ADSs or ordinary shares as capital assets (generally, property held for investment). This discussion does not discuss all aspects of U.S. federal income taxation which may be important to particular investors in light of their individual circumstances, including investors subject to special taxation, such as:

- banks and financial institutions;
- brokers and dealers in securities or currencies;
- insurance companies;
- tax-exempt organizations and retirement plans;
- grantor trusts;
- S corporations;
- persons holding ADSs or ordinary shares as part of hedging, conversion, constructive sale, straddle or other integrated transactions;
- persons who acquired their ordinary shares upon the exercise of employee stock options or otherwise as compensation;
- persons who have elected the mark-to-market method of accounting;
- persons who own 10% or more of our ADSs or shares;
- real estate investment trusts or regulated investment companies;
- U.S. persons whose “functional currency” is not the U.S. dollar;
- certain former citizens or long-term residents of the United States; and
- Non-U.S. Holders (as defined below).

This discussion is based in part on representations by the depositary and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms. Furthermore,

the discussion below is based upon the provisions of the Internal Revenue Code of 1986, as amended (the “Code”), and U.S. Treasury regulations, rulings and judicial decisions hereunder as of the date hereof. Such authorities are subject to change, possibly on a retroactive basis, which may result in U.S. federal income tax consequences different from those discussed below.

A person considering an investment in our ADSs or ordinary shares is urged to consult its tax advisor concerning U.S. federal, state, local and non-U.S. income and other tax consequences.

A U.S. Holder is a beneficial owner of ADSs or ordinary shares that is for U.S. federal income tax purposes:

- a citizen or resident individual of the United States;
- a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States, any state thereof, or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation, regardless of its source; or
- a trust if it is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

A beneficial owner of ADSs or ordinary shares that is not a U.S. Holder is referred to herein as a “Non-U.S. Holder.” If a partnership or limited liability company treated as a partnership for U.S. federal income tax purposes holds ADSs or ordinary shares, the tax treatment of a partner or member will generally depend on the status of the partner or member and the activities of the partnership or such limited liability company. A partner of a partnership or a member of such a limited liability company holding ADSs or ordinary shares is urged to consult its tax advisors regarding an investment in our ADSs or ordinary shares.

ADSs. In general, for U.S. federal income tax purposes, a U.S. Holder of ADSs will be treated as the owner of the underlying ordinary shares that are represented by such ADSs. Deposits and withdrawals of ordinary shares in exchange for ADSs will not be subject to U.S. federal income taxation.

Distributions on ADSs or ordinary shares. Unless the passive foreign investment company rules, as discussed below, apply, the gross amount of the distributions in respect of the ADSs or ordinary shares will be subject to tax as dividend income to the extent of our current and accumulated earnings and profits, as determined under U.S. federal income tax principles. Subject to certain limitations, dividends paid to non-corporate U.S. Holders, including individuals, may be eligible for a reduced rate of taxation if we are deemed to be a “qualified foreign corporation” for U.S. federal income tax purposes, provided that such holder satisfies certain holding period requirements with respect to the ownership of our ADSs or ordinary shares. Subject to the exceptions discussed below, a corporation is a qualified foreign corporation if it is:

- a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States that includes an exchange of information program; or
- a foreign corporation if its stock with respect to which a dividend is paid or its ADSs backed by such stock are readily tradable on an established securities market within the United States.

The Cayman Islands does not currently have a comprehensive income tax treaty with the United States. A foreign corporation (even if it is described above) does not constitute a qualified foreign corporation if, for the taxable year in which the dividend is paid or the preceding taxable year, the foreign corporation is or was a passive foreign investment company. Although we believe that we are a qualified foreign corporation because the ADSs will be traded on an established U.S. securities market and, as discussed below, we believe that we were not a passive foreign investment company for our 2018 tax year, no assurance can be given in this regard. In addition, our status as a qualified foreign corporation may change. A U.S. Holder that exchanges its ADSs for ordinary shares may not be eligible for the reduced rate of taxation on dividends if the ordinary shares are not deemed to be readily tradable on an established securities market within the United States.

Dividends will be includable in a U.S. Holder's gross income on the date actually or constructively received by the depository, in the case of ADSs or, in the case of ordinary shares, by such U.S. Holder. These dividends will not be eligible for the dividends-received deduction generally allowed to U.S. corporations in respect of dividends received from other U.S. corporations.

To the extent we pay dividends on the ADSs or ordinary shares in a currency other than the U.S. dollar, the U.S. dollar value of such dividends should be calculated by reference to the exchange rate prevailing on the date of actual or constructive receipt of the dividend, regardless of whether the foreign currency is converted into U.S. dollars at that time. If the foreign currency is converted into U.S. dollars on the date of actual or constructive receipt of such dividends, the tax basis of the U.S. Holder in such foreign currency will be equal to its U.S. dollar value on that date and, as a result, the U.S. Holder generally should not be required to recognize any foreign currency exchange gain or loss. Dividends paid in respect of the ADSs or ordinary shares generally will be treated as income from sources outside the United States.

To the extent that the amount of any distribution exceeds our current and accumulated earnings and profits, the distribution will first be treated as a tax-free return of capital, causing a reduction in the adjusted basis of the ADSs or ordinary shares, and the balance in excess of adjusted basis will be taxed as capital gain.

Sale, exchange or other disposition of ADSs or ordinary shares. Unless the passive foreign investment company rules, as discussed below, apply, upon the sale, exchange or other disposition of ADSs or ordinary shares a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized upon the sale, exchange or other disposition and the adjusted tax basis of the U.S. Holder in the ADSs or ordinary shares. The capital gain or loss generally will be long-term capital gain or loss if, at the time of sale, exchange or other disposition, the U.S. Holder has held the ADS or ordinary share for more than one year. Net long-term capital gains of non-corporate U.S. Holders, including individuals, are eligible for reduced rates of taxation. The deductibility of capital losses is subject to limitations. Any gain or loss that a U.S. Holder recognizes generally will be treated as gain or loss from sources within the United States for U.S. foreign tax credit limitation purposes.

Additional tax on net investment income. An additional 3.8% federal income tax may be assessed on net investment income (including dividends, other distributions, and gain realized on the sale of ADSs or ordinary shares) earned by certain U.S. Holders. This tax does not apply to U.S. Holders who hold ADSs or ordinary shares in the ordinary course of certain trades or businesses.

Passive foreign investment company rules. In general, we will be classified as a passive foreign investment company for any taxable year in which either (a) at least 75% of our gross income is passive income or (b) at least 50% of the value (determined on the basis of a quarterly average) of our assets is attributable to assets that produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents (other than rents and royalties derived in the active conduct of a trade or business and not derived from a related person), annuities and gains from assets that produce passive income. If we own directly or indirectly at least 25% by value of the equity shares of another corporation, we will be treated for purposes of the passive foreign investment company tests as owning a proportionate share of the assets of the other corporation, and as receiving directly a proportionate share of the other corporation's income.

We believe, based on our present and projected composition of our income and valuation of our assets, we were not classified as a passive foreign investment company for U.S. federal income tax purposes for our 2018 tax year, although no assurance can be given in this regard. Whether we are a passive foreign investment company for any particular taxable year is determined on an annual basis and will depend on the composition of our income and assets, including goodwill. The calculation of goodwill will be based, in part, on the then market value of our capital stock, which is subject to fluctuation. Accordingly, there can be no assurance that we will not be classified as a passive foreign investment company in the current or any future taxable year.

If we are a passive foreign investment company for any taxable year during which a U.S. Holder has an equity interest in our company, unless the U.S. Holder makes a mark-to-market election as discussed below, such U.S. Holder will be subject to special tax rules in any future taxable year regardless of whether we are classified as a passive foreign investment company in such future years with respect to (a) “excess distributions” and (b) gain from the disposition of stock. Excess distributions are defined generally as the excess of the amount received with respect to the equity interests in the taxable year over 125% of the average annual distributions received in the shorter of either the three previous years or a U.S. Holder’s holding period before the taxable year and must be allocated ratably to each day of the U.S. Holder’s holding period. The amount allocated to the current taxable year or any year before we became a passive foreign investment company will be included as ordinary income in a U.S. Holder’s gross income for that year. The amount allocated to other prior taxable years will be taxed as ordinary income at the highest rate in effect for a U.S. Holder in that prior year and the tax is subject to an interest charge at the rate applicable to deficiencies in income taxes. The entire amount of any gain realized upon the sale or other disposition of the equity interests will be treated as an excess distribution made in the year of sale or other disposition and as a consequence will be treated as ordinary income and, to the extent allocated to years prior to the year of sale or disposition with respect to which we were a passive foreign investment company, will be subject to the interest charge described above.

In certain circumstances, instead of being subject to the excess distribution rules discussed above, a U.S. Holder may make an election to include gain on the ADSs or ordinary shares of a passive foreign investment company as ordinary income under a mark-to-market method, provided that the ADSs or ordinary shares are regularly traded on a qualified exchange. Under current law, the mark-to-market election is only available for ADSs or ordinary shares that are regularly traded within the meaning of U.S. Treasury regulations on certain designated U.S. exchanges and foreign exchanges that meet trading, listing, financial disclosure and other requirements to be treated as a qualified exchange under applicable U.S. Treasury regulations. The Nasdaq Stock Market is a qualified exchange. The ordinary shares may not be eligible for mark-to-market treatment under the foregoing rule even if the ADSs otherwise satisfy the applicable requirement.

If a U.S. Holder makes a mark-to-market election, the U.S. Holder will include each year as ordinary income, rather than capital gain, the excess, if any, of the fair market value of the U.S. Holder’s ADSs or ordinary shares at the end of the taxable year over such U.S. Holder’s adjusted basis in the ADSs (or ordinary shares, if applicable) and will be permitted an ordinary loss in respect of the excess, if any, of the adjusted basis of these ADSs or ordinary shares over their fair market value at the end of the taxable year, but only to the extent of the net amount previously included in income as a result of the mark-to-market election. A U.S. Holder’s basis in the ADSs or ordinary shares will be adjusted to reflect any such income or loss amounts. Any gain or loss on the sale of the ADSs or ordinary shares will be ordinary income or loss, except that this loss will be ordinary loss only to the extent of the previously included net mark-to-market gain.

If we are a passive foreign investment company, then under certain circumstances a U.S. Holder must file Internal Revenue Service Form 8621.

Information Reporting and Back-up Withholding. The Foreign Account Tax Compliance Act (“FATCA”) generally requires that individuals that hold certain specified foreign financial assets worth in excess of certain thresholds of \$50,000 or more, depending on the individual’s circumstances, report such ownership to the IRS using IRS Form 8938. The definition of specified foreign financial assets includes not only financial accounts maintained in foreign financial institutions, but also, unless held in accounts maintained by a financial institution, any stock or security issued by a non-U.S. person, any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. person and any interest in a foreign entity. A U.S. Holder may be subject to this reporting requirement unless such holder’s ADSs or ordinary shares are held in an account at a domestic financial institution. The penalty for failing to file Form 8938 is substantial.

U.S. holders generally are subject to information reporting requirements with respect to dividends on, or proceeds from the disposition of, our ordinary shares. In addition, a U.S. holder may be subject, under certain circumstances, to backup withholding at a rate of up to 24% with respect to dividends paid on, or proceeds from

the disposition of, our ordinary shares unless the U.S. holder provides proof of an applicable exemption or correct taxpayer identification number, and otherwise complies with the applicable requirements of the backup withholding rules. A U.S. holder of our ordinary shares who provides an incorrect taxpayer identification number may be subject to penalties imposed by the IRS. Amounts withheld under the backup withholding rules are not an additional tax and may be refunded or credited against the U.S. holder's U.S. federal income tax liability, provided the required information is furnished to the IRS.

A U.S. Holder is urged to consult its tax advisor concerning the U.S. federal income tax consequences of an investment in our ADSs or ordinary shares if we are or become a passive foreign investment company, including the possibility of making a mark-to-market election.

Cayman Islands Taxation

The Cayman Islands currently levy no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to our company levied by the Government of the Cayman Islands except for stamp duties that may be applicable on instruments executed in, or after execution brought within the jurisdiction of, the Cayman Islands. The Cayman Islands are not party to any double taxation treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

We have, pursuant to Section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, obtained an undertaking from the Governor-in-Council that:

- no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciation applies to us or our operations; and
- the aforesaid tax or any tax in the nature of estate duty or inheritance tax are not payable on our ordinary shares, debentures or other obligations.

The undertaking that we have obtained is for a period of 20 years from March 1, 2005.

In December 2018, the Cayman Islands published The International Tax Co-operation (Economic Substance) Law in response to the OECD's Base Erosion and Profit Shifting (BEPS) standards. Silicon Motion Technology Corp. is a Cayman company and may be affected by the new law's economic substance requirements, which require companies registered in the Cayman Islands to show business activity in the Caymans, tax residency elsewhere, or be subject to penalties. Economic substance requirements will apply to existing Cayman companies, such as our company, from July 1, 2019. See "Risk Factor — The enactment of legislation implementing changes in taxation of international business activities, the adoption of other tax reform policies or change in tax legislation or policies could materially impact our financial position and results of operations."

Documents on Display

We have previously filed with the SEC our registration statement on Form F-6 under the Securities Act of 1933, as amended (the "Securities Act") with respect to our ADSs.

We are subject to the periodic reporting and other informational requirements of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). Under the Exchange Act, we are required to file reports and other information with the SEC. Specifically, we are required to file annually a Form 20-F no later than four months after the close of each fiscal year, which is December 31. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and our officers, directors, and principal shareholders are exempt from the reporting and short-swing profit recovery provisions of Section 16 of the Exchange Act.

Copies of reports and other information, when so filed, may be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the Securities and Exchange Commission at the SEC's public reference room in Washington D.C. at 100 F Street, N.E., Room 1580, Washington D.C. 20549. You can request copies of these documents upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. The SEC also maintains a Website at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate risk. Our exposure to changes in interest rates is limited to interest income generated by our cash deposited with banks and short-term investments maintained in bond funds, principal protected notes and interest expenses payable on our bank loans. We have not entered into any interest rate swap transactions. We do not believe that a 1% change in interest rates would have a significant impact on our operations.

Foreign currency risk. Since 2012, we consider our direct exposure to foreign exchange rate fluctuations to be minimal. Prior to 2012, we reported our financial results in NT dollars and our direct exposure to foreign exchange rate fluctuations was more significant. Gains or losses from foreign currency re-measurement are included in "Non-Operating Income (Expenses)" in our Consolidated Financial Statements. The impact of foreign currency transaction gain or loss included in determining net income (loss) for 2016, 2017 and 2018 was US\$(0.7) million, US\$(0.2) million and US\$(0.6) million, respectively. Currently, the majority of our revenue, cost of sales, accounts receivable, and accounts payable are denominated in U.S. dollars. Increases in the value of the U.S. dollar relative to other currencies would make our products more expensive, which could negatively impact our ability to compete. Conversely, decreases in the value of the U.S. dollar relative to other currencies could result in our suppliers raising their prices in order to continue doing business with us. Fluctuations in currency exchange rates could harm our business in the future. We do not utilize foreign exchange derivatives contracts to protect against changes in foreign exchange rates.

Also refer to "Risk Factors — We are subject to risks associated with international operations which may harm our business."

Investment Risk. We invest in equity instruments of privately held companies. We have minority stake equity investments in Cashido, Vastview and Deep Vision, private companies related to the semiconductor and other technology industries. These investments are accounted for under the cost method because our ownership is less than 20% and we do not have the ability to exercise significant influence over the operations of these companies. In 2018, we invested in 49% of the equity of ProGrade and accounted for this investment under the equity method. As of December 31, 2018, the aggregate carrying value of these investments on our balance sheet was US\$4.2 million. We monitor these investments for impairment and make appropriate reductions in carrying value when an impairment is deemed to be other than temporary. The impairments losses for the years ended on December 31, 2016, 2017 and 2018 were US\$13 thousand, US\$120 thousand and nil, respectively.

As of December 31, 2018, we also had the short-term investments of US\$3.6 million in principal protected notes.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Depository Fees and Charges. For the year-ended December 31, 2018, we received from our depository bank a reimbursement of US\$0.8 million, net of withholding tax, for our continuing annual stock exchange listing fees and our other expenses incurred in connection with maintaining and promoting our ADS program. In addition, the depository bank has agreed to reimburse us annually for a fixed number of years for our continuing annual stock exchange listing fees and our other expenses incurred in connection with maintaining and promoting our ADS program. The amount of annual reimbursements is subject to certain limits.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2018. Disclosure controls and procedures are designed to ensure that the material financial and non-financial information required to be disclosed in this annual report on Form 20-F and filed with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The evaluation was performed with the participation of our key corporate senior management, and under the supervision of our Chief Financial Officer, or CFO, Riyadh Lai, and our President and Chief Executive Officer, or CEO, Wallace Kou. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, rather than absolute, assurances of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the foregoing, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective.

Management's Report on Internal Control over Financial Reporting

Our management, including our CEO and CFO, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined under Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of the end of the period covered by this annual report based on the criteria set forth in the Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Their assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of our internal control over financial reporting. Based on that assessment, our management concluded that as of December 31, 2018 the company's internal control over financial reporting was effective.

Deloitte & Touche, the independent registered public accounting firm that audited our consolidated financial statements included in this annual report has issued an attestation report regarding internal control over financial reporting.

Changes in Internal Control over Financial Reporting

During 2018, no change to our internal control over financial reporting occurred that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

All internal control systems no matter how well designed and implemented have inherent limitations. Even systems determined to be effective may not prevent or detect misstatements or fraud and can only provide reasonable assurance with respect to disclosure and financial statement presentation and reporting. Additionally, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changed conditions and the degree of compliance with the policies or procedures may deteriorate.

Attestation Report Of The Independent Registered Public Accounting Firm

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of
Silicon Motion Technology Corporation

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Silicon Motion Technology Corporation and subsidiaries (the “Company”) as of December 31, 2018, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control — Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2018, of the Company and our report dated May 15, 2019 expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control over Financial Reporting

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Deloitte & Touche
Taipei, Taiwan
The Republic of China
May 15, 2019

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Tsung-Ming Chung, the Chairman of our audit committee and an independent director, is an "audit committee financial expert" under Nasdaq and SEC rules.

ITEM 16B. CODE OF ETHICS

Our board of directors has adopted a code of business conduct and ethics applicable to every employee of our company, including our CEO and our CFO, consistent with the requirements of the Nasdaq Stock Market. A copy of our code of ethics has been filed with the SEC as Exhibit 11.1 to our annual report on Form 20-F filed on June 30, 2006. For further information, see our Code of Ethics posted on our website (www.siliconmotion.com).

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Deloitte & Touche has acted as the independent registered public accountants of our company and its subsidiaries for 2017 and 2018. The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by Deloitte & Touche for the periods indicated.

	<u>2017</u>	<u>2018</u>
	US\$	US\$
	(in thousands)	
Audit Fees ⁽¹⁾	880	1,011
Audit-Related Fees ⁽²⁾	—	—
Tax Fees ⁽³⁾	213	200
All Other Fees ⁽⁴⁾	—	—
Total	1,093	1,211

- (1) *Audit Fees.* This category includes the audit and review of our annual financial statements and services that are normally provided by the independent auditors in connection with regulatory filings or engagements, consultations provided on audit and accounting matters that arise during, or as a result of, the audits or the reviews of interim financial statements, audit procedures related to reviews of offering documents, registration statements and issuance of comfort letters.

- (2) *Audit-Related Fees.* This category consists of assurance and related services by Deloitte & Touche that are reasonably related to the performance of the audit or review of our financial statements and are not reported above under “Audit Fees.” Deloitte & Touche did not provide any services under this category in 2017 or 2018.
- (3) *Tax Fees.* This category consists of professional services rendered by Deloitte & Touche for tax compliance and tax advice. The services for the fees disclosed in this category include tax return preparation and technical tax advice.
- (4) *All other fees.* Deloitte & Touche did not provide any services under this category in 2017 or 2018.

Our audit committee is responsible for the retention of our independent registered public accounting firm, which currently is Deloitte & Touche. Our audit committee has adopted its own rules of procedure, in the form of an audit committee charter. The audit committee’s rules of procedure provide for a process with respect to the prior approval of all non-audit services to be performed by our independent auditors. Our audit committee reports to our board of directors regarding the scope and results of our annual audits, compliance with our accounting and financial policies and management’s procedures and policies related to the adequacy of our internal accounting controls.

In 2018 our audit committee approved all of the audit services provided by Deloitte & Touche and the other services provided by Deloitte & Touche.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not applicable.

ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

We are incorporated in the Cayman Islands and our corporate governance practices are governed by applicable Cayman Islands law. In addition, because our ADSs are listed on the Nasdaq Global Select Market, we are subject to Nasdaq corporate governance requirements. Nasdaq Listing Rule 5615(a)(3) permits foreign private issuers like us to follow “home country practice” with respect to certain corporate governance matters, such as, for example, our establishment in 2015 of our 2015 Incentive Plan. We are committed to a high standard of corporate governance. As such, we endeavor to comply with the Nasdaq corporate governance practices and believe that we are currently in compliance with Nasdaq corporate governance practices that are applicable to foreign private issuers.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

Our consolidated financial statements are included in this annual report at pages F-1 through F-39.

ITEM 19. EXHIBITS

Exhibit Number	Description
1.1	Memorandum of Association of the Registrant (incorporated by reference to Exhibit 3.1 to the company's Registration Statement on Form F-1 (file no. 333-125673) filed with the Securities and Exchange Commission on June 9, 2005).
1.2	Articles of Association of the Registrant (incorporated by reference to Exhibit 3.2 to the company's Registration Statement on Form F-1 (file no. 333-125673) filed with the Securities and Exchange Commission on June 9, 2005).
2.1	Specimen of American Depositary Receipt (incorporated by reference to Exhibit 4.1 to the company's Registration Statement on Form F-1 (file no. 333-125673) filed with the Securities and Exchange Commission on June 9, 2005).
2.2	Form of Deposit Agreement (incorporated by reference to Exhibit 4.2 to the company's Registration Statement on Form F-1 (file no. 333-125673) filed with the Securities and Exchange Commission on June 9, 2005).
2.3	Second Amended and Restated Silicon Motion Technology Corporation Equity Incentive Plan 2005 (incorporated by reference to Exhibit 2.3 of the company's Form 20-F for the year ended December 31, 2009, filed June 25, 2010).
2.4	Silicon Motion Technology Corporation 2015 Incentive Plan (incorporated by reference to Exhibit 4.1 of the Company's registration statement on Form S-8 filed June 11, 2015).
4.11	Purchase and Supply Agreement between Lexar Media, Inc. and Silicon Motion Technology Corporation, dated September 1, 2005 (incorporated by reference to Exhibit 4.11 to the Company's Annual Report on Form 20-F filed with the Securities and Exchange Commission on June 30, 2006).
4.12	Share Purchase Agreement dated as of April 18, 2007 among Silicon Motion Technology Corporation, Lake Tahoe Investment Corporation, FCI Inc. and Kwang Jun Yun and the shareholders of FCI (incorporated by reference to Exhibit 4.12 to the Company's Annual Report on Form 20-F filed with the Securities and Exchange Commission on July 2, 2007).
4.13	Share Purchase Agreement dated as of April 24, 2015 among Silicon Motion Technology Corporation, Silicon Motion Technology (Hong Kong) Ltd., F-Tec Holdings International Ltd., the shareholders of F-Tec Holdings International Ltd. and Xueshi Yang, as the Sellers' Representative (incorporated by reference to Exhibit 4.13 to the Company's Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 30, 2015).
8.1*	List of Subsidiaries.
11.1	Code of Ethics (incorporated by reference to Exhibit 11.1 to the company's Annual Report on Form 20-F filed with the Securities and Exchange Commission on June 30, 2006).
12.1*	Certification of Chief Executive Officer Required by Rule 13a-14(a).
12.2*	Certification of Chief Financial Officer Required by Rule 13a-14(a).

Exhibit Number	Description
13.1*	Certification of Chief Executive Officer and Chief Financial Officer required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
23.1*	Consent of Deloitte & Touche.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

SIGNATURES

The registrant hereby certifies that it meets all the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

SILICON MOTION TECHNOLOGY CORPORATION

By: _____ /s/ WALLACE C. KOU
Wallace C. Kou,
President and Chief Executive Officer

Date: May 15, 2019

SILICON MOTION TECHNOLOGY CORPORATION AND SUBSIDIARIES
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of
Silicon Motion Technology Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Silicon Motion Technology Corporation and subsidiaries (the “Company”) as of December 31, 2017 and 2018, the related consolidated statements of income, comprehensive income, changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 15, 2019, expressed an unqualified opinion on the Company’s internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Deloitte & Touche
Taipei, Taiwan
The Republic of China
May 15, 2019

We have served as the Company’s auditor since 1999.

SILICON MOTION TECHNOLOGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Par Value)

	December 31	
	2017	2018
	US\$	US\$
ASSETS		
Current Assets		
Cash and cash equivalents	359,453	284,989
Short-term investments	6,941	3,609
Notes and accounts receivable, net	79,135	91,763
Inventories	94,186	81,518
Restricted assets-current	19,515	19,157
Noncurrent assets held for sale	—	10,576
Prepaid expenses and other current assets	9,567	6,878
Total current assets	568,797	498,490
Long-term investments	—	4,242
Property and equipment, net	51,370	101,410
Deferred income tax assets, net	3,402	5,066
Goodwill	58,964	58,331
Intangible assets, net	7,429	1,021
Other assets	3,770	4,054
Total assets	693,732	672,614
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes and accounts payable	56,423	27,657
Bank loan	25,000	—
Income tax payable	11,492	4,163
Refund liabilities	—	2,093
Current portion of long-term payable	566	319
Accrued expenses and other current liabilities	83,763	79,419
Total current liabilities	177,244	113,651
Long-term payable, net of current portion	108	—
Other long-term liabilities	22,329	26,686
Total liabilities	199,681	140,337
Commitments and Contingencies (Note 19)		
Shareholders' Equity		
Ordinary Shares at US\$ 0.01 par value per share		
Authorized: 500,000 thousand shares		
Issued and outstanding: 143,162 thousand shares in 2017 and 144,679 thousand shares in 2018	1,431	1,447
Additional paid-in capital	242,487	263,230
Accumulated other comprehensive income	2,643	495
Retained Earnings	247,490	301,860
Treasury Stock	—	(34,755)
Total shareholders' equity	494,051	532,277
Total liabilities and shareholders' equity	693,732	672,614

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

SILICON MOTION TECHNOLOGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Earnings Per Share)

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
NET SALES	556,146	523,404	530,348
COST OF SALES	281,541	272,210	269,541
GROSS PROFIT	274,605	251,194	260,807
OPERATING EXPENSES			
Research and development	92,405	102,053	102,028
Sales and marketing	25,765	25,868	29,279
General and administrative	17,072	16,933	17,633
Impairment of goodwill and intangible assets	—	10,337	4,069
Amortization of intangible assets	2,103	2,534	2,964
Gain from disposal of noncurrent assets held for sale	—	(1,880)	—
Total operating expenses	137,345	155,845	155,973
OPERATING INCOME	137,260	95,349	104,834
NON-OPERATING INCOME (EXPENSES)			
Gain from disposal of short-term investments	2	103	134
Interest income	2,158	4,268	6,301
Foreign exchange gain (loss), net	(692)	(157)	(615)
Impairment of long-term investments	(13)	(120)	—
Interest expense	(127)	(423)	(378)
Loss on equity-method investment	—	—	(473)
Other income (loss), net	42	(19)	58
Total non-operating income	1,370	3,652	5,027
INCOME BEFORE INCOME TAX	138,630	99,001	109,861
INCOME TAX EXPENSE	27,690	24,046	11,791
NET INCOME	110,940	74,955	98,070
EARNINGS PER ORDINARY SHARE:			
Basic	0.79	0.53	0.68
Diluted	0.78	0.52	0.68
WEIGHTED AVERAGE ORDINARY SHARES OUTSTANDING			
Basic (Thousands)	140,919	142,738	144,123
Diluted (Thousands)	142,050	143,606	144,512
EARNINGS PER ADS (one ADS equals four ordinary shares):			
Basic	3.15	2.10	2.72
Diluted	3.12	2.09	2.71
WEIGHTED AVERAGE ADS OUTSTANDING			
Basic (Thousands)	35,230	35,684	36,031
Diluted (Thousands)	35,513	35,902	36,128

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

SILICON MOTION TECHNOLOGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	<u>Year Ended December 31</u>		
	<u>2016</u>	<u>2017</u>	<u>2018</u>
	US\$	US\$	US\$
NET INCOME	110,940	74,955	98,070
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX EFFECT OF NIL			
Change in net foreign currency translation adjustments	(1,555)	3,390	(2,148)
Change in deferred pension gain (loss)	(110)	285	—
OTHER COMPREHENSIVE INCOME (LOSS)	<u>(1,665)</u>	<u>3,675</u>	<u>(2,148)</u>
TOTAL COMPREHENSIVE INCOME	<u>109,275</u>	<u>78,630</u>	<u>95,922</u>

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

SILICON MOTION TECHNOLOGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(In Thousands, Except Per Share Data)

	Ordinary Share		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total Shareholders' Equity
	Shares (thousands)	Amount US\$					
BALANCE, JANUARY 1, 2016	139,521	1,395	209,243	633	133,227	—	344,498
Net income	—	—	—	—	110,940	—	110,940
Other comprehensive income	—	—	—	(1,665)	—	—	(1,665)
Stock-based compensation expenses	—	—	17,364	—	—	—	17,364
Issuance of ordinary shares upon exercise of employee stock options and restricted stock units	1,790	18	51	—	—	—	69
Dividends declared (US\$0.20 per ordinary share)	—	—	—	—	(28,443)	—	(28,443)
BALANCE, DECEMBER 31, 2016 . .	141,311	1,413	226,658	(1,032)	215,724	—	442,763
Net income	—	—	—	—	74,955	—	74,955
Other comprehensive income	—	—	—	3,675	—	—	3,675
Stock-based compensation expenses	—	—	15,494	—	—	—	15,494
Issuance of ordinary shares upon exercise of employee stock options and restricted stock units	1,851	18	335	—	—	—	353
Dividends declared (US\$0.30 per ordinary share)	—	—	—	—	(43,189)	—	(43,189)
BALANCE, DECEMBER 31, 2017 . .	143,162	1,431	242,487	2,643	247,490	—	494,051
Net income	—	—	—	—	98,070	—	98,070
Other comprehensive income	—	—	—	(2,148)	—	—	(2,148)
Stock-based compensation expenses	—	—	20,779	—	—	—	20,779
Issuance of ordinary shares upon exercise of employee stock options and restricted stock units	1,517	16	(36)	—	—	—	(20)
Share repurchase	—	—	—	—	—	(34,755)	(34,755)
Dividends declared (US\$0.30 per ordinary share)	—	—	—	—	(43,700)	—	(43,700)
BALANCE, DECEMBER 31, 2018 . .	144,679	1,447	263,230	495	301,860	(34,755)	532,277

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

SILICON MOTION TECHNOLOGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	110,940	74,955	98,070
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,482	10,599	11,832
Amortization of intangible assets	2,103	2,534	2,964
Gain from disposal of short-term investments	(2)	(103)	(134)
Loss on equity-method investment	—	—	473
Impairment of long-term investments	13	120	—
Stock-based compensation	17,364	15,494	20,779
Loss on disposal of property and equipment	33	4	66
Impairment of goodwill and intangible assets	—	10,337	4,069
Gain from disposal of noncurrent assets held for sale	—	(1,880)	—
Deferred income taxes	(3,373)	581	(1,664)
Changes in operating assets and liabilities:			
Short-term investments	(2,710)	(3,208)	3,240
Notes and accounts receivable	(14,620)	(5,156)	(12,628)
Inventories	(24,777)	(22,299)	12,668
Prepaid expenses and other current assets	(1,313)	1,585	2,689
Other assets	(5)	(138)	142
Notes and accounts payable	9,198	24,248	(28,766)
Refund liabilities	—	—	2,093
Accrued expenses and other current liabilities	12,180	458	(4,679)
Income tax payable	6,876	(8,779)	(7,329)
Other liabilities	4,179	4,529	4,357
Net cash provided by operating activities	<u>125,568</u>	<u>103,881</u>	<u>108,242</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of long-term investment	—	—	(4,715)
Proceeds from sale of held-to-maturity financial assets	4,000	—	—
Business acquisition-net of cash, cash equivalents, and restricted cash acquired	—	(2,865)	—
Purchase of property and equipment	(12,220)	(11,683)	(74,853)
Net cash used in investing activities	<u>(8,220)</u>	<u>(14,548)</u>	<u>(79,568)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of ordinary shares upon exercise of employee stock options	93	380	—
Proceeds from bank loan	25,000	25,000	—
Repayments of bank loan	—	(25,000)	(25,000)
Dividends paid	(22,899)	(32,120)	(43,281)
Share repurchase	—	—	(33,539)
Net cash provided by (used in) financing activities	<u>2,194</u>	<u>(31,740)</u>	<u>(101,820)</u>
NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH			
CASH	119,542	57,593	(73,146)
EFFECT OF EXCHANGE RATE CHANGES	(521)	2,753	(1,250)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, BEGINNING OF YEAR	<u>202,156</u>	<u>321,177</u>	<u>381,523</u>
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, END OF YEAR	<u>321,177</u>	<u>381,523</u>	<u>307,127</u>
SUPPLEMENTAL INFORMATION			
Interest paid	<u>105</u>	<u>367</u>	<u>376</u>
Income taxes paid	<u>24,300</u>	<u>30,910</u>	<u>13,792</u>
Acquisition of Bigtera (Note 3)			
Fair value of assets acquired, net of cash, cash equivalents, and restricted cash acquired	—	4,586	—
Other current liabilities	—	(1,244)	—
Other long-term liabilities	—	(477)	—
Cash paid for business acquisition, net of cash, cash equivalents, and restricted cash acquired	<u>—</u>	<u>2,865</u>	<u>—</u>

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

SILICON MOTION TECHNOLOGY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands)

1. THE COMPANY

Silicon Motion Technology Corporation (“SMTC”, collectively with its subsidiaries the “Company”) is the global leader in selling NAND flash controllers for solid state storage devices and the merchant leader in supplying SSD controllers. The Company has the broadest portfolio of controller technologies and its controllers are widely used in embedded storage products such as SSDs and eMMC and UFS devices, which are found in smartphones, PCs and commercial and industrial applications. It has shipped over six billion NAND controllers in the last ten years, more than any other company in the world. The Company also supplies customized high-performance hyperscale data center and industrial SSD solutions. The Company’s customers include most of the NAND flash vendors, storage device module makers and leading OEMs. For further information on Silicon Motion, visit us at www.siliconmotion.com.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with U.S. GAAP. The consolidated financial statements include the accounts of SMTC and its wholly-owned subsidiaries. The Company owns 100% of the outstanding shares in all of its subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. The actual results could differ from those estimates.

Concentration of Credit Risk and Significant Customers

Financial instruments that potentially subject the Company to a significant concentration of credit risk consist principally of cash equivalents, short term investments and accounts receivable. Cash, cash equivalents and short-term investments balances are maintained with high quality financial institutions, the composition and maturities of which are regularly monitored by management. The Company believes that the concentration of credit risk in its trade receivables, is substantially mitigated by the Company’s credit evaluation process, relatively short collection terms and the high level of credit worthiness of its customers. The Company performs ongoing credit evaluations of its customers’ financial conditions and limits the amount of credit extended based upon payment history and the customer’s current credit worthiness. The Company regularly reviews the allowance for bad debt and doubtful accounts by considering factors such as historical experience, credit quality, age of the accounts receivable balances and current economic conditions that may affect a customer’s ability to pay.

Historically, a relatively small number of customers have accounted for a significant portion of our net revenue. Sales to one customer in 2016, and two customers in 2017 and 2018 accounted for 10% or more of the Company’s net sales, and these sales represented 28%, 39% and 34% of the Company’s net sales in 2016, 2017 and 2018, respectively. In 2016, the significant customer was SK Hynix and in 2017 and 2018, SK Hynix and Intel. The Company’s top ten customers in 2016, 2017 and 2018 accounted for approximately 75%, 72% and 69% of net sales, respectively.

Fair Value of Financial Instruments

The carrying amount of the Company's financial instruments, including cash and cash equivalents, notes and accounts receivable and notes and accounts payables approximates fair value due to the short-term maturity of the instruments. Fair values of short-term investments represent quoted market prices, if available. If no quoted market prices are available, fair values are estimated based on discounted cash flow, or other valuation techniques. Long-term investments in privately-held companies with no readily determinable market value are recorded using the cost method, since the cost of obtaining verifiable fair value is unreasonably high. Upon adoption of Accounting Standard Update No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01") starting January 1, 2018, these investments are measured at cost less impairment, if any, plus or minus any changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. Any resulting change in carrying amount would be reflected in net income. The Company's long-term liabilities approximate their fair values as they contain interest rates that vary according to market interest rates.

Fair value is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that assets or liability. The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the Company. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 — Use unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 — Use observable inputs other than Level 1 prices such as quoted prices for identical or similar instruments in markets that are not active, quoted prices for similar instruments in active markets, and model-based valuation in which all significant inputs are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Use inputs that are generally unobservable and reflect the use of significant management judgments and estimates.

See Note 21, "Fair Value Measurement", for the related disclosure.

Cash Equivalents

The Company considers all highly liquid instruments acquired with a remaining maturity of three months or less when purchased to be cash equivalents. In addition, time deposits with maturities ranging from more than three months to one year are qualified as cash equivalents as the nature of the time deposits are similar to cash such that without advance notice to the bank, they can be readily converted into known amounts of cash with the principal of the time deposits protected and not subject to penalty in the event of an early withdrawal. Also, the risk of changes in value because of changes in interest rates is insignificant due to the fact that the Company can still earn interest based on a rate close to the on-going published interest rate applicable for the actual period of the time deposits in the event of an early withdrawal. Cash and cash equivalents are stated at cost, which approximates their fair value.

Short-term Investments

The Company's short-term investments primarily include short-term income yielding investments with original maturities greater than three months from the purchase date and remaining maturities less than one year.

These short-term investments consist mostly of bond funds and principal protected notes that are bought and held principally for the purpose of selling them in the near term and are classified as trading securities as well as senior notes classified as held-to-maturity investments with maturities less than one year. Trading securities are reported at fair value with the subsequent changes in fair value recorded in earnings as unrealized gains and losses. Senior notes are measured at amortized cost using the effective interest method less any impairment.

Allowance for Doubtful Receivables

An allowance for doubtful receivables is provided based on a review of the collectability of accounts receivables. The Company determines the amount of allowance for doubtful receivables by examining the historical collection experience and current trends in the credit quality of its customers as well as its internal credit policies.

Inventories

Inventories are stated at the lower of cost or market value. Inventories are recorded at standard cost and adjusted to the approximate weighted-average cost at the balance sheet date. Market value represents the current replacement cost for raw materials, work in process and finished goods. The Company assesses its inventory for estimated obsolescence or unmarketable inventory based upon management's assumptions about future demand and market conditions. In estimating reserves for obsolescence, the Company primarily evaluates estimates based on the timing of the introduction of new products and the quantities remaining of old products and provides reserves for inventory on hand in excess of the estimated demand. Estimated losses on slow-moving items are recognized and included in the allowance for losses.

Long-term Investments

Investee companies over which the Company had the ability to exercise significant influence but did not have a controlling interest and was the primary beneficiary were accounted for using the equity method. Significant influence was generally considered to exist when the Company had an ownership interest in the voting shares of the investee between 20% and 50%, and other factors, such as representation in the investee's board of directors, voting rights and the impact of commercial arrangements, were considered in determining whether the equity method of accounting was appropriate. Under this method of accounting, the Company recorded its proportionate share of the net earnings or losses of equity method investees and a corresponding increase or decrease to the investment balances. The Company evaluated its equity method investments for impairment whenever events or changes in circumstances indicated that the carrying amounts of such investments might not be recoverable.

Prior to adopting ASU 2016-01 on January 1, 2018, the Company has long-term investments in companies that it does not exercise significant influence and accounts for these investments under the cost method. Management regularly evaluates financial information related to these investments to determine whether an other than temporary decline in their value exists. Factors indicative of an other than temporary decline include recurring operating losses, credit defaults and subsequent rounds of financings at an amount below the cost basis of the investment. Management periodically weighs all quantitative and qualitative factors in determining if any impairment loss exists. When a decline in value is deemed to be other-than-temporary, the Company recognizes an impairment loss in other income and expense. After adopting ASU 2016-01 on January 1, 2018, the Company elected to record equity investments without readily determinable fair values and not accounted for by the equity method at cost less impairment, adjusted for subsequent observable price changes whether there are observable price changes in orderly transactions for the identical or similar investment of the same issuer.

Noncurrent Assets Held for Sale

Non-current assets are presented separately as held for sale when the Company is committed to selling the asset, an active plan of sale has commenced, and the sale is expected to be completed within 12 months. Assets held for sale are measured at the lower of their carrying amount and fair value less cost to sell. Assets held for sale are no longer amortized or depreciated.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Significant additions, renewals and betterments are capitalized, while maintenance and repairs are expensed as incurred.

Depreciation is computed using the straight-line method over estimated useful lives that range as follows: buildings — 25 to 50 years; machinery and equipment — 3 to 6 years; furniture and fixtures — 3 to 8 years; software — 1 to 5 years; leasehold and buildings improvement — the shorter of the estimated useful life or lease term, which is generally 2 to 6 years. Land is not depreciated. Depreciation expense recognized for the years ended December 31, 2016, 2017 and 2018 was approximately US\$9,482 thousand, US\$10,599 thousand and US\$11,832 thousand, respectively.

Upon the sale or other disposal of property and equipment, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss is credited or charged to operating income.

Government Grants

Grants received by the Company from the Korean government to assist with specific research and development activities are deducted from those research and development costs incurred, in the period in which the related expenses are incurred, to the extent that they are non-refundable. Government grants that were used for the acquisition of fixed assets are deducted from the acquisition costs of the acquired assets and amortized over the useful lives of the related assets. The Company recognizes refundable government grants as long-term payable and current portion of long-term payable on its consolidated balance sheet.

Goodwill and Intangible Assets

Goodwill is the excess of the purchase price paid over the fair value of the net tangible and intangible assets acquired in a business combination. Intangible assets, which consist primarily of development technology, are amortized over their estimated useful lives, of 3.5 to 5.5 years.

Impairment of Goodwill and Long-Lived Assets

The Company evaluates the recoverability of long-lived assets whenever events or changes in circumstances indicate the carrying value may not be recoverable. The determination of recoverability is based on an estimate of undiscounted cash flows expected to result from the use of an asset and its eventual disposition. The estimate of cash flows is based upon, among other things, certain assumptions about expected future operating performance, growth rates and other factors. Estimates of undiscounted cash flows may differ from actual cash flows due to, among other things, technological changes, economic conditions, changes to the business model or changes in operating performance. If the sum of the undiscounted cash flows is less than the carrying value, an impairment loss is recognized, measured as the amount by which the carrying value exceeds the fair value of the asset. Fair value is determined by reference to quoted market prices, if available, or discounted cash flows, as appropriate. See Note 11, “Goodwill and Acquired Intangible Assets,” regarding impairment testing in fiscal year 2016, 2017 and 2018.

The Company monitors the recoverability of goodwill recorded in connection with acquisitions, by reporting unit, annually, or sooner if events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company conducts its annual impairment test of goodwill on November 30. Reporting units may be operating segments as a whole or an operation one level below an operating segment, referred to as a component. Prior to fiscal 2017, goodwill impairment is tested using a two-step approach. The first step compares the fair value of a reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit is greater than its carrying amount, goodwill is not considered impaired and the second step is not required. If the fair value of the reporting unit is less than its carrying amount, the second step of the impairment

test measures the amount of the impairment loss, if any, by comparing the implied fair value of goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized equal to that excess. The implied fair value of goodwill is calculated in the same manner that goodwill is calculated in a business combination, whereby the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit, with the excess purchase price over the amounts assigned to assets and liabilities.

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2017-04, which removes step two from the goodwill impairment test. The Company elected to early adopt this ASU in the fourth quarter of 2017, in conjunction with the Company’s annual review for impairment.

Estimating fair value is performed by utilizing various valuation approaches, such as income approach or market approach. The total of all reporting unit fair values is also compared to the Company’s market capitalization plus control premium for reasonableness. See Note 11, “Goodwill and Acquired Intangible Assets,” regarding impairment testing.

Other Assets

Other assets primarily consist of industrial property right and deposits for office leases.

Restricted Assets

Restricted assets consist of restricted cash. Restricted cash represents cash set aside as collateral for obtaining capacity and borrowings as well as cash received from government grants with restriction on its usage.

Bank loans

Revolver credit from financial institutions are stated at the amount of unpaid principal.

Other long-term liabilities

Other long-term liabilities primarily consist of payables to former shareholders of Shannon Systems and unrecognized tax benefits.

Pension Costs

For employees under defined contribution pension plans, pension costs are recorded based on the actual contributions made to employees’ individual pension accounts. For employees under defined benefit pension plans, pension costs are recorded based on actuarial calculations.

Revenue Recognition

Through the fiscal year ended December 31, 2017, revenue from product sales was generally recognized upon shipment to the customer provided that the Company had received a signed purchase order, the price was fixed or determinable, transfer of title had occurred in accordance with the shipping terms specified in the arrangement with the customer, collectability from the customer was considered reasonably assured, product returns were reasonably estimable and there were no remaining significant obligations or customer acceptance requirements. Revenue on development service orders was generally recognized upon completion and customer acceptance of contractually agreed milestones.

As a result of the adoption of the new revenue standard (ASC 606) on January 1, 2018, using the modified retrospective method with the cumulative effect of initially applying it recognized at the date of initial

application, the Company revised its revenue recognition policy. The Company now recognizes revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. Under the new revenue recognition standard, the Company applies the following five step approach: (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when a performance obligation is satisfied.

The Company enters into contracts that may include products that are capable of being distinct and accounted for as separate performance obligations. To date, the majority of the revenue has been generated by sales associated with products of storage and mobile communication, where a single performance obligation is identified in general. Revenue from services has been insignificant. Performance obligations associated with product sales transactions are generally satisfied when control passes to customers upon shipment or the written acceptance of the customers. Accordingly, product revenue is recognized at a point in time when control of the asset is transferred to the customer. The Company recognizes revenue when it satisfies a performance obligation by transferring control of a product to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods. Some of the Company's sales are made to distributors. Control passes to the distributor upon shipment, and terms and payment by the Company's distributors is not contingent on resale of the product.

The Company grants certain distributors limited rights of return and price protection rights on unsold products. The return rights are generally limited to five percent of the monetary value of products purchased within the preceding six months, provided that the distributor places a corresponding restocking order of equal or greater value. An allowance for sales returns for distributors and all customers is recorded at the time of sale based on historical returns information available, management's judgment and any known factors at the time the financial statements are prepared that would significantly affect the allowance. Price protection rights are based on the inventory products the distributors have on hand at the date the price protection is offered. The actual price adjustments to distributors incurred by the Company are minimal.

The Company provides a standard one-year warranty for manufacturing defects of its products. Warranty returns have been infrequent and relate to defective or off-specification parts. The Company estimates a reserve for warranty based on historical experience and records this amount to cost of sales. For the years ended December 31, 2016, 2017 and 2018, the Company did not experience significant costs associated with warranty returns.

The effect of retrospectively applying ASC 606 is detailed below:

	<u>As previously Reported</u>	<u>New Revenue Standard Adjustment</u>	<u>As Adjusted</u>
Impact on Assets and liabilities			
Refund liabilities	\$ —	\$ 2,093	\$2,093
Allowance for sales returns and discounts*	<u>2,093</u>	<u>(2,093)</u>	<u>—</u>
Total effect on Assets and liabilities	<u>\$2,093</u>	<u>\$ —</u>	<u>\$2,093</u>

* Prior to the application of ASC 606, the Company recognized the estimation of sales returns and allowance as a credit to accounts receivables. Under ASC 606, the Company recognizes such estimation as refund liability.

Research and Development

Research and development costs consist of expenditures incurred during the course of planned research and investigation aimed at the discovery of new knowledge that will be useful in developing new products or at

significantly enhancing existing products as well as expenditures incurred for the design and testing of product alternatives. All expenditures related to research and development activities of the Company are charged to operating expenses when incurred. Third-party research and development costs are expensed when the contracted work has been performed or as milestone results have been achieved.

Income Taxes

The provision for income tax represents income tax paid and payable for the current year plus changes in the deferred income tax assets and liabilities during the years. Deferred income tax assets are recognized for net operating loss carryforwards, research and development credits, and temporary differences. The Company believes that uncertainty exists regarding the realizability of certain deferred income tax assets and, accordingly, has established a valuation allowance for those deferred income tax assets to the extent the realizability is not deemed to be more likely than not. Deferred income tax assets and liabilities are measured using enacted tax rates.

The Company utilizes a two step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained in a dispute with taxing authorities, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties related to unrecognized tax benefits in income tax expense.

Foreign Currency Transactions

Foreign currency transactions are recorded at the rates of exchange in effect when the transaction occurs. Gains or losses, resulting from the application of different foreign exchange rates when cash in foreign currency is converted into the entities' functional currency, or when foreign currency receivables and payables are settled, are credited or charged to income in the period of conversion or settlement. At the balance sheet date, assets and liabilities denominated in foreign currencies are remeasured based on prevailing exchange rates and any resulting gains or losses are credited or charged to income.

Translation of Foreign Currency Financial Statements

The reporting currency of the Company is the U.S. dollars. The functional currency of some of the Company's subsidiaries is the local currency of the respective entity. Accordingly, the financial statements of the foreign subsidiaries were translated into U.S. dollars at the following exchange rates: assets and liabilities — current rate on the balance sheet date; shareholders' equity — historical rates; income and expenses — average rate during the period. The resulting translation adjustment is recorded as a separate component of comprehensive income.

Comprehensive Income (Loss)

Comprehensive income and loss represents net income (loss) plus the results of certain changes in shareholders' equity during a period from non-owner sources. The following table presents the components of accumulated other comprehensive income (loss) as of December 31, 2016, 2017 and 2018:

	Year Ended December 31, 2016			Year Ended December 31, 2017			Year Ended December 31, 2018		
	US\$			US\$			US\$		
	Foreign currency items	Defined benefit pension plans	Accumulated other comprehensive income (loss)	Foreign currency items	Defined benefit pension plans	Accumulated other comprehensive income (loss)	Foreign currency items	Defined benefit pension plans	Accumulated other comprehensive income (loss)
Beginning balance	1,486	(853)	633	(69)	(963)	(1,032)	3,321	(678)	2,643
Current-period change . .	(1,555)	(110)	(1,665)	3,390	285	3,675	(2,148)	—	(2,148)
Ending balance	<u>(69)</u>	<u>(963)</u>	<u>(1,032)</u>	<u>3,321</u>	<u>(678)</u>	<u>2,643</u>	<u>1,173</u>	<u>(678)</u>	<u>495</u>

Legal Contingencies

The Company is regularly involved in various claims and legal proceedings. Periodically, the Company reviews the status of each significant matter and assesses the potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be estimated, the Company accrues a liability for the estimated loss. Because of uncertainties related to these matters, accruals are based only on the best information available at the time. As additional information becomes available, the Company reassesses the potential liability related to the pending claims and litigation and revises these estimates as appropriate. Such revisions in the estimates of the potential liabilities could have a material impact on the results of operations and financial position.

Earnings Per Share

Basic earnings per share are computed by dividing net earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if stock options and other dilutive securities were exercised. Dilutive securities are excluded from the computation of the diluted income per share in periods when their effect is anti-dilutive. The Company's dilutive securities consist of employee stock options and restricted stock units. The effect of dilutive securities including employee stock options and restricted stock units were 1,131 thousand shares (283 thousand ADSs), 868 thousand shares (218 thousand ADSs) and 389 thousand shares (97 thousand ADSs) for the years ended December 31, 2016, 2017 and 2018, respectively.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718 Compensation — Stock Compensation. The Company uses the Black-Scholes valuation model for the valuation of stock options and recognizes compensation expense on a straight-line basis over the requisite service period of the award. The value of our restricted stock units is based on the fair value of our shares on the date of grant and expensed over the vesting period.

Prior to the initial declaration of a quarterly cash dividend on January 22, 2013, the fair value of restricted stock units ("RSUs") was measured based on the grant date share price, as the Company did not historically pay cash dividends on our common stock. For awards granted on or subsequent to January 22, 2013, the fair value of RSUs was measured based on the grant date share price, less the present value of expected dividends during the vesting period, discounted at a risk-free interest rate.

Treasury Stock

Treasury stock is stated at cost and shown as a reduction to shareholders' equity. A repurchase of ADSs is recorded as treasury stock until the Company completes the withdrawal of the underlying ordinary shares from the ADS program.

Dividends

The board of directors declared payment of our first quarterly dividend on our common stock in January 2013 and the first dividend payment was made on March 4, 2013. The board of directors has subsequently declared and paid dividends in each successive quarter. Beginning on November 2, 2015, the board of directors, instead of declaring a quarterly dividend, declared an annual dividend payable in four quarterly installments. The payment of future cash dividends are subject to the Board's continuing determination that the payment of dividends are in the best interests of the Company's shareholders and are in compliance with all laws and agreements of the Company applicable to the declaration and payment of cash dividends.

Recent Accounting Pronouncements

In May 2014, the FASB issued a new standard related to revenue recognition. Under the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued an amendment to defer the effective date. The new standard is effective for fiscal years beginning after December 15, 2017 and early adoption is permitted for annual reporting periods beginning after December 15, 2016. In March and April 2016, the FASB issued two accounting updates to clarify the implementation guidance on principal versus agent considerations, performance obligations and licensing. In addition, the FASB issued another accounting update in May 2016 to address narrow-scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition and provides a practical expedient for contract modifications at transition. The new guidance is required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying it recognized at the date of initial application. The Company adopted this new standard using the modified retrospective method with the cumulative effect of initially applying it recognized at the date of initial application. The adoption of this new standard did not have a material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In January 2016, the FASB issued an accounting update regarding the subsequent measurement of equity investment. The amendment requires all equity investment to be measured at fair value with changes in the fair value recognized through net income other than those accounted for under equity method of accounting or those that result in consolidation of the investee. The amendment also simplifies the impairment assessment of equity investments without readily determinable fair value by requiring assessment for impairment qualitatively and eliminating the complexity of the other-than-temporary impairment guidance. For financial reporting, the amendment requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendment eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. In February 2018, the FASB issued an accounting update to further clarify certain aspects of the guidance in the recognition and the measurement of financial assets and financial liabilities. The amendments are effective for fiscal years beginning after December 15, 2017 and early application is prohibited. The adoption of this amendment did not have a material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In February 2016, the FASB issued a new standard regarding leases (Topic 842). The new standard requires an entity to recognize assets and liabilities arising from a lease for both financing and operating leases other than

that the entity elects the short-term lease recognition and measurement exemption. Qualitative and quantitative disclosures will be enhanced to better understand the amount, timing and uncertainty of cash flows arising from leases. In January 2018, the FASB issued an amendment permits an entity to elect an optional transition practical expedient to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under Topic 840, the current standard regarding leases. In July 2018, the FASB issued two amendments to (1) clarify how to apply certain aspects of the new leases standard addressing the rate implicit in the lease, lessee reassessment of lease classification, lessor reassessment of lease term and purchase options, among other issues; (2) provide an optional transition method that allows the entity to initially apply the new lease requirements by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without restating prior periods; and (3) provide an practical expedients that lease and associated non-lease components are not required to be separated within lessor arrangements if certain criteria are met. In addition, in December 2018, the FASB issued another accounting update regarding lease to clarify guidance for lessors on sales taxes and other similar taxes collected from lessees, certain lessor costs and recognition of variable payments for contracts with lease and non-lease components. The standard is effective for the Company beginning on January 1, 2019. The Company is adopting the new lease accounting standard using a modified retrospective method and will not restate comparative periods. The Company expects that the adoption of the new leasing standard will result in recognition of US\$7,886 thousand in lease related right-of-use assets and liabilities on the Company's consolidated balance sheet, primarily related to office buildings.

In June 2016, the FASB issued an accounting update to amend the guidance on the impairment of financial instruments that are not measured at fair value through profit and loss. The amendment introduces a current expected credit loss (CECL) model based on expected losses rather than incurred losses to estimate credit losses on financial instruments measured at amortized cost and requires a broader range of reasonable and supportable information to estimate expected credit loss. In addition, under the amendment, an entity recognizes an allowance for expected credit losses on financial instruments measured at amortized cost and available-for-sale debt securities rather than the current methodology of delaying recognition of credit losses until it is probable a loss has been incurred. In November 2018, the FASB issued an accounting update to clarify that receivables arising from operating leases are not within the scope of new credit losses guidance. Instead, impairment of receivables arising from operating leases should be accounted for in accordance with Topic 842, Leases. The amendment is effective for fiscal years beginning after December 15, 2019, and earlier adoption is permitted as of the fiscal years beginning after December 15, 2018. The adoption of the amendments is not expected to have a material impact on the Company's statement of cash flows.

In August 2016, the FASB issued an accounting update to clarify the following eight cash flow classification issues: (1) debt prepayment or debt extinguishment costs, (2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (3) contingent consideration payments made after the acquisition date of a business combination, (4) proceeds received from the settlement of insurance claims, (5) proceeds received from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (6) distributions received from equity method investees, (7) beneficial interests in securitization transactions, and (8) separately identifiable cash flows and application of the predominance principle. The amendment is an improvement to reduce the current and potential future diversity in practice. The amendment is effective for fiscal years beginning after December 15, 2017, and earlier adoption is permitted. In addition, the amendment should be applied using a retrospective transition method to each period presented. The adoption of the amendments did not have a material impact on the Company's statement of cash flows.

In October 2016, the FASB issued an accounting update to simplify the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The amendment removes the prohibition against the recognition of current and deferred income tax effects of intra-entity transfers of assets other than inventory until the asset has been sold to an outside party. The amendment is effective for fiscal years beginning after December 15, 2017, and earlier adoption is permitted. The adoption of this amendment did not have a

material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In November 2016, the FASB issued an accounting update related to the classification and presentation of changes in restricted cash on the statement of cash flows. The amendment requires restricted cash or restricted cash equivalents should be included with cash and cash equivalent when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendment is effective for fiscal years beginning after December 15, 2017, and early adoption is permitted. The Company has elected to adopt the amendment as of December 31, 2016, and the retrospective transition approach is applied to prior reporting periods presented.

In January 2017, the FASB issued an accounting update to clarify the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendment provides a screen to determine when an integrated set of assets and activities (collectively referred to as a "set") is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. If the screen is not met, the amendment requires that to be considered a business, a set must include an input and a substantive process that together significantly contribute to the ability to create output. The amendment is effective for fiscal years beginning after December 15, 2017. The adoption of this amendment did not have a material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In January 2017, the FASB issued an accounting update to simplify the accounting treatment for the impairment of goodwill. The amendment eliminates Step 2 from the goodwill impairment test, which measures a goodwill impairment loss by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. Instead, under this amendment, the entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value and the impairment loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendment is effective for fiscal years beginning after December 15, 2019, and early adoption is permitted. The Company adopted this amendment beginning in fiscal 2017 and performed the annual goodwill impairment test in accordance with the amended guidance. Refer to Note 11 for discussion of the annual goodwill impairment test.

In February 2017, the FASB issued an accounting update to clarify the scope of asset derecognition guidance and accounting for partial sales of nonfinancial assets. The amendment defines the term "in substance nonfinancial asset" as a financial asset promised to counterparty in a contract if substantially all of the fair value of assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets and clarifies that an entity should identify each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it. The amendment also clarifies that an entity should allocate consideration to each distinct asset by applying the guidance in Topic 606 on allocating the transaction price to performance obligations. Under this amendment, an entity is required to derecognize a distinct nonfinancial asset or distinct in substance nonfinancial asset in a partial sale transaction when it (1) does not have (or ceases to have) a controlling financial interest in the legal entity that holds the asset in accordance with Topic 810 and (2) transfers control of the asset in accordance with Topic 606. Once an entity transfers control of a distinct nonfinancial asset or distinct in substance nonfinancial asset, it is required to measure any noncontrolling interest it receives (or retains) at fair value. The amendment is effective for fiscal years beginning after December 15, 2017 and early adoption is permitted. The amendment should be applied on a full or modified retrospective basis. The adoption of this amendment did not have a material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In March 2017, the FASB issued an accounting update to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amendment requires that an entity disaggregates the service

cost component from the other components of net benefit cost and present the service cost component with other current compensation costs for related employees in the income statement. The amendment also requires an entity presents the other components elsewhere in the income statement and outside of income from operation if such subtotal is presented and allow only the service cost component of net benefit cost to be eligible for capitalization. The amendment is effective for fiscal years beginning after December 15, 2017 and early adoption is permitted. The amendment should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The amendment allows for a practical expedient that permits an entity to use the amounts disclosed in its pension and other postretirement benefit plan note for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements. The Company intends not to apply the practical expedient for retrospective presentation requirements. The adoption of this amendment did not have a material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In May 2017, the FASB issued an accounting update to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation — Stock Compensation, to a change in the terms or conditions of a share-based payment award. Under the amendment, modification accounting is required to be applied unless all of the following are the same immediately before and after the change: (1) the award's fair value (or calculated value or intrinsic value, if those measurement methods are used); (2) the award's vesting conditions; and (3) the award's classification as an equity or liability instrument. The amendment is effective for fiscal years beginning after December 15, 2017 and early adoption is permitted. The amendment should be applied prospectively to an award modified on or after the adoption date. The adoption of this amendment did not have a material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In August 2018, the FASB issued an accounting update to amend fair value measurement disclosure requirements to eliminate, add and modify certain disclosures to improve the effectiveness of such disclosure. The amendments removed (1) the disclosure requirements for transfers between Levels 1 and 2 of the fair value hierarchy, (2) the policy for timing of transfers between levels of the fair value hierarchy; and (3) the valuation processes for Level 3 fair value measurements. Additionally, the amendments modified the disclosure requirements for investments in certain entities that calculate net asset value and measurement uncertainty. Finally, the amendments added disclosure requirements for the changes in unrealized gains and losses included in other comprehensive income for recurring Level 3 fair value measurements and the range and weighted average of significant unobservable inputs used to develop Level 3 measurements. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. This amendment is effective for annual periods beginning after December 15, 2019. Early adoption is permitted. The adoption of this amendment is not expected to have a material impact on the Company's financial position, results of operations, cash flow and financial statement disclosures.

In August 2018, the FASB issued an accounting update to modify disclosure requirements by removing, modifying and clarifying disclosures related to defined benefit plans. This amendment modified the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. Certain disclosure requirements have been removed while the disclosure requirements of (1) the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates; and (2) an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period, have been added. The amendment also clarified the disclosure requirements with respect to the projected benefit obligation and the accumulated benefit obligation. The amendment is effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The amendments should be applied on a retrospective basis to all periods

presented. The adoption of this amendment is not expected to have a material impact on the Company’s financial position, results of operations, cash flow and financial statement disclosures.

3. BUSINESS ACQUISITION

Bigtera

On July 3, 2017, the Company completed its acquisition of Bigtera, a software defined storage company. In exchange for 100% of the outstanding shares of common stock of Bigtera, the Company paid approximately US\$4,664 thousand in cash. In 2017, the Company incurred US\$171 thousand of acquisition costs which comprised primarily of transaction fees and direct acquisition costs, including legal and other professional fees. These costs are included in the line item of “operating expenses — general and administrative” on the consolidated statements of income.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

	US\$
Cash, cash equivalents and restricted cash	78
Accounts receivable, net	380
Other current assets	14
Property and equipment	15
Goodwill	625
Identifiable intangible assets	4,736
Accounts payable	(436)
Accrued expenses and other current liabilities	(748)
Net assets acquired	<u>4,664</u>

As of December 31, 2018, approximately US\$1,099 thousand has not been paid to the former shareholders of Bigtera and is included in other current liabilities on the consolidated balance sheets as of December 31, 2018.

The excess of the purchase price over the fair value of the net tangible assets acquired has been reflected as identifiable intangible assets. The identifiable intangible assets and respective useful lives are as follows:

	US\$	Useful Life
Know-how	3,753	5.5
Current technology	<u>983</u>	5.5
Total identifiable intangible assets	<u>4,736</u>	

Know-how represents software defined storage technology that has value through its continued use or reuse across all version of Bigtera’s software products. Such know-how derives independent value from not being generally known and is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Current technology represents the part of technology that is unique in current version of software products.

Goodwill represents the excess of the purchase price over the estimated fair values of the net tangible and intangible assets. The factors that contributed to the recognition of goodwill primarily relate to expansion into new product areas and potential synergies created from combined capabilities, and goodwill is not expected to be deductible for tax purposes.

The results of Bigtera since the acquisition date included on the consolidated statement of income for the year ended December 31, 2017 were as follows:

	US\$
Net sales	2,993
Net income	(314)

The operating results of Bigtera have been included in the Company's operations beginning July 3, 2017. The following unaudited pro forma information represents a summary of the results of operations as if the acquisition occurred on January 1, 2016 and 2017 and includes certain pro forma adjustments, including amortization of identifiable intangibles from that date (in thousands except earnings per share):

	<u>Year Ended December 31</u>	
	<u>2016</u>	<u>2017</u>
Net sales	557,672	523,849
Net income	109,736	73,834
Earnings per share		
Basic	0.78	0.52
Diluted	0.77	0.51
Weighted average ordinary shares outstanding (thousand)		
Basic	140,919	142,738
Diluted	142,050	143,606

The pro forma results are based on various assumptions and are not necessarily indicative of what would have occurred had the acquisition closed on January 1, 2016 and 2017.

4. CASH, CASH EQUIVALENTS, AND RESTRICTED CASH

	<u>December 31</u>	
	<u>2017</u>	<u>2018</u>
	US\$	US\$
Cash and deposits in bank	59,751	54,918
Time deposits	269,392	220,047
Bonds acquired under repurchase agreements	30,310	10,024
Total cash and cash equivalents	359,453	284,989
Restricted cash	22,070	22,138
	<u>381,523</u>	<u>307,127</u>

5. SHORT-TERM INVESTMENTS

	<u>December 31</u>	
	<u>2017</u>	<u>2018</u>
	US\$	US\$
Trading securities	6,941	3,609

The Company classified certain short-term investments as trading securities. Realized gains on sales of these trading securities were US\$2 thousand, US\$103 thousand and US\$134 thousand for the years ended December 31, 2016, 2017 and 2018, respectively. The amount of unrealized losses related to trading securities at year end was nil for the years ended December 31, 2016, 2017 and 2018, respectively.

6. NOTES AND ACCOUNTS RECEIVABLE

	<u>December 31</u>	
	<u>2017</u>	<u>2018</u>
	US\$	US\$
Trade accounts receivable	81,165	92,408
Allowance for doubtful accounts	(598)	(645)
Allowance for sales returns and discounts (Note 13)* . .	(1,432)	—
	<u>79,135</u>	<u>91,763</u>

* As of January 1, 2018, the Company has adopted the new revenue recognition standard (ASC 606). Allowance for sales returns and discounts for the year ended December 31, 2018 has been adjusted to reflect these changes in accounting policies, see Note 2 summary of significant accounting policies.

The changes in the allowances are summarized as follows:

	<u>Year Ended December 31</u>		
	<u>2016</u>	<u>2017</u>	<u>2018</u>
	US\$	US\$	US\$
Allowances for doubtful accounts			
Balance, beginning of year	775	723	598
Additions (reversals) charged to expense, net	(12)	(125)	47
Write-offs	(40)	—	—
Balance, end of year	<u>723</u>	<u>598</u>	<u>645</u>

	<u>Year Ended December 31</u>	
	<u>2016</u>	<u>2017</u>
	US\$	US\$
Allowances for sales returns and discounts		
Balance, beginning of year	1,555	1,624
Additions charged to expense, net	3,285	3,093
Actual sales return and discount	(3,216)	(3,285)
Balance, end of year	<u>1,624</u>	<u>1,432</u>

7. INVENTORIES

The components of inventories are as follows:

	<u>December 31</u>	
	<u>2017</u>	<u>2018</u>
	US\$	US\$
Finished goods	41,365	26,059
Work in process	25,090	30,830
Raw materials	27,731	24,629
	<u>94,186</u>	<u>81,518</u>

The Company wrote down US\$2,995 thousand, US\$698 thousand and US\$2,095 thousand in 2016, 2017 and 2018, respectively, for estimated obsolete or unmarketable inventory.

8. LONG-TERM INVESTMENTS

As of December 31, 2017 and 2018, the Company held equity investments in several privately-held companies with the carrying value as follows:

	Percentage of Ownership		December 31	
	2017	2018	2017 US\$	2018 US\$
Cost method in 2017 and cost less impairment method in 2018:				
Cashido Corp. (Cashido)	2.1%	1.8%	—	—
Vastview Technology, Corp. (Vastview)	2.9%	2.9%	—	—
Deep Vision, Inc (Deep Vision)	—	14.8%	—	3,000
Equity method:				
ProGrade Digital, Inc. (ProGrade)	—	49.0%	—	1,242
			—	4,242
			==	==

In July 2001, the Company invested in the common stock of Cashido. At the time of investment, Cashido manufactured flash memory storage devices. Cashido currently focuses on the manufacture of computer accessories and ozone based sterilization devices. In 2017, the Company recognized impairment charges of US\$91 thousand in its investment in Cashido. In 2016 and 2017, the Company recognized impairment charges of US\$13 thousand and US\$91 thousand in its investment in Cashido, respectively.

In December 2006 and February 2007, the Company invested US\$3,360 thousand in the common stock of Vastview. Vastview is a fabless semiconductor company that develops and markets driver ICs and other ICs for the TFT-LCD industry. In 2009 and 2013, the Company received US\$808 thousand and US\$46 thousand from capital reductions at Vastview. From 2008 to 2010, the Company recognized impairment charges of US\$2,462 thousand in its investment in Vastview, and an additional charge of US\$29 thousand in 2017. The impairment charges were mainly due to the declining financial performances of the investee.

In May 2018, the Company invested US\$1,715 thousand in the preferred stock of ProGrade which is accounted for under the equity method. ProGrade is a supplier of professional-grade memory cards.

In June 2018, the Company invested US\$3,000 thousand in the preferred stock of Deep Vision which is accounted for under the cost method. Deep Vision is a developer of low-power deep learning processors.

9. NONCURRENT ASSETS HELD FOR SALE

	December 31	
	2017 US\$	2018 US\$
Assets held for sale	—	10,576
	—	10,576
	==	==

The Company vacated from an office building located in Shanghai, China and in 2018 took actions to sell the property. The sale plans met all of the held-for-sale criteria in accordance with ASC 360 — Property, Plant and Equipment and accordingly, the office building was reclassified to noncurrent assets held for sale in 2018. In 2017, the Company sold another held for sale property to a non-affiliated third party and recognized a gain from disposal of US\$1,880 thousand.

10. PROPERTY AND EQUIPMENT

	December 31	
	2017	2018
	US\$	US\$
Cost:		
Land	9,309	68,243
Buildings	30,288	18,130
Machinery and equipment	21,665	26,902
Furniture and fixtures	7,746	8,538
Leasehold and buildings improvement	5,497	7,661
Software	24,864	23,971
Total	99,369	153,445
Accumulated depreciation:		
Buildings	3,472	3,231
Machinery and equipment	15,665	19,005
Furniture and fixtures	5,212	5,808
Leasehold and buildings improvement	4,213	4,921
Software	19,874	19,269
	48,436	52,234
Prepayment and construction in progress	437	199
	51,370	101,410

In April 2006, the Company began leasing a property located in Taipei, Taiwan to a third party. The lessee has been renewing the operating lease annually and last renewed in March 2019. Net carrying value of the properties as of December 31, 2017 and 2018 was US\$709 thousand and US\$691 thousand, respectively. Annual rental income from the lease is about US\$42 thousand each year.

In September 2018, the Company paid \$58,931 thousand to acquire land in Hsinchu, Taiwan for the purpose of constructing its future Taiwan headquarters building.

11. GOODWILL AND ACQUIRED INTANGIBLE ASSETS

Intangible assets: The cumulative value of intangible assets related to the Company's acquisition of FCI and Centronix in 2007, BTL in 2011, Shannon Systems in 2015 and Bigtera in 2017 are as follows:

	December 31							
	2017				2018			
	US\$				US\$			
	Cost	Accumulated Impairment	Accumulated Amortization	Net Carrying Amount	Cost	Accumulated Impairment	Accumulated Amortization	Net Carrying Amount
Acquisition-related intangible assets	13,117	—	(5,688)	7,429	13,117	(3,444)	(8,652)	1,021

The Company assesses the impairment of intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. No impairment losses were recognized in 2016 and 2017. In 2018, the Company determined that the carrying amounts for intangible assets of its Bigtera unit exceeded its fair value, which was close to nil, and recorded impairment charges of US\$3,444 thousand due to lower than projected revenue. The impairment was measured based on a projected discounted cash flow method. Certain factors, such as revenue growth rates, projected gross margins, perpetual growth rate and risk-adjusted discount rate used for this nonrecurring fair value measurement were considered Level 3 within the fair value hierarchy due to the significance of unobservable inputs using company specific information. Amortization expense of acquisition-related intangible assets for the years ended December 31, 2016, 2017 and 2018 were US\$2,103 thousand, US\$2,534 thousand and US\$2,964 thousand, respectively.

Goodwill: Goodwill is not amortized, but instead is reviewed and tested for impairment at least annually or whenever events or circumstances occur which indicate that goodwill might be impaired. The goodwill that resulted from the Company's acquisition of FCI and Centronix in 2007 and purchase of BTL's assets in 2011 was US\$66,300 thousand. As a result of the acquisition of Shannon Systems in 2015 and Bigtera in 2017, the Company recorded additional goodwill of US\$33,204 thousand and US\$625 thousand, respectively. Impairment of goodwill is tested at the Company's reporting unit level by comparing the carrying amount, including goodwill, to the fair value. In performing the analysis, the Company uses the best information available, including reasonable and supportable assumptions and projections. Goodwill is tested for impairment annually on November 30. Total goodwill was US\$58,964 thousand and US\$58,331 thousand as of December 31, 2017 and 2018, respectively. The Company recognizes an impairment charge for the amount by which the carrying amount of the reporting unit exceeds its implied fair value.

The Company elected to adopt ASU 2017-04 starting 2017 (as described in Note 2 above). Under the updated guidance, the Company applied a one-step quantitative test and recorded the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value. Fair value determinations are sensitive to changes in the underlying assumptions and factors including those relating to estimating future operating cash flows to be generated from the reporting unit which are dependent upon historical data and internal forecasts and projections developed by management. The Company's strategic plans, estimates of perpetual growth rate taking into account the annual goodwill impairment analysis of the current economic environment and the timing and degree of any economic recovery and market participant assumptions. Key assumptions within the five-year discounted cash flow analysis prepared for the annual goodwill impairment analysis included revenue growth rates, projected gross margins, perpetual growth rate and risk-adjusted discount rate that the Company determined to be appropriate. The inputs used are classified as Level 3 within the fair value hierarchy due to the significance of unobservable inputs using company-specific information. As a result of the goodwill impairment tests conducted as of November 30, 2017 and 2018, the Company determined that the carrying amounts for mobile communications unit and Bigtera unit exceeded the fair value and recorded goodwill impairment charges of US\$10,337 thousand and US\$625 thousand in the fourth quarter of 2017 and 2018, respectively. The company used an income approach (discounted cash flow model) to determine the fair value of the mobile communications unit and the Bigtera unit. Mobile communications unit impairment charge in 2017 was mainly attributable to a project cancellation by a customer and delayed commercialization of a new product. Bigtera unit impairment charge in 2018 was mainly due was to lower than projected revenue.

	December 31							
	2017				2018			
	US\$				US\$			
	Cost	Accumulated Impairment	Foreign Currency Adjustment	Net Carrying Amount	Cost	Accumulated Impairment	Foreign Currency Adjustment	Net Carrying Amount
Goodwill	100,129	(41,145)	(20)	58,964	100,129	(41,770)	(28)	58,331

12. SHORT-TERM BANK LOANS

	December 31	
	2017	2018
	US\$	US\$
Secured loans	25,000	—
	25,000	—

Interest expenses for the years ended December 31, 2016, 2017 and 2018 were US\$105 thousand, US\$387 thousand and US\$355 thousand, respectively.

The Company obtained US dollar revolver credit facilities from banks and drew down US\$25,000 thousand in 2017. The loan was repaid in 2018. Interest rates ranged from 1.51% to 2.95% per annum on monthly outstanding loans. In 2017 and 2018, loans no longer required pledged deposits.

13. REFUND LIABILITIES

	December 31, 2018
	<u>US\$</u>
Refund liabilities (Note 6)	<u>2,093</u>

Estimated sales returns and other allowances is made and adjusted based on historical experience and the consideration of varying contractual terms.

The changes in the refund liabilities are summarized as follows:

	Year Ended December 31, 2018
	<u>US\$</u>
Refund liabilities	
Balance, beginning of year	1,432
Additions charged to expense, net	4,908
Actual sales return and discount	<u>(4,247)</u>
Balance, end of year	<u>2,093</u>

14. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

	December 31	
	<u>2017</u>	<u>2018</u>
	<u>US\$</u>	<u>US\$</u>
Wages and bonus	29,629	25,169
Dividends	32,451	32,871
Research and development payable	5,638	3,108
License fees and royalties	3,729	6,739
Professional fees	2,286	1,867
Equipment	1,844	1,264
Others	<u>8,186</u>	<u>8,401</u>
	<u>83,763</u>	<u>79,419</u>

15. PENSION PLAN

SMI Taiwan, the Company's largest operating company is a Taiwan registered company and subject to Taiwan's Labor Pension Act (the "Act"), which became effective on July 1, 2005, and the pension mechanism under the Act is deemed a defined contribution plan. The employees who were subject to the Labor Standards Law prior to July 1, 2005 could choose to be subject to the pension mechanism under the Act or continue to be subject to the pension mechanism under the Labor Standards Law. For those employees who were subject to the Labor Standards Law prior to July 1, 2005 and still work for the same company after July 1, 2005 and have chosen to be subject to the pension mechanism under the Act, their seniority as of July 1, 2005 were maintained. The Act prescribes that the rate of contribution by an employer to employees' pension accounts per month will not be less than 6% of each employee's monthly salary. According to the Act, SMI Taiwan made monthly contributions and recognized pension costs of US\$1,272 thousand, US\$1,579 thousand and US\$1,682 thousand for the years ended December 31, 2016, 2017 and 2018, respectively.

The Company provides a defined benefit plan to the employees of SMI Taiwan under the Labor Standards Law that offers benefits based on an employee's length of service and average monthly salary for the six-month period prior to retirement. The Company contributes an amount equal to 2% of salaries paid each month to a pension funds (the "Funds"), which is administered by the Labor Pension Fund Supervisory Committee established by the government (the "Committee") and deposited in the Committee's name in the Bank of Taiwan. Before the end of each year, the Company assesses the balance in the Funds. If the amount of the balance in the Funds is inadequate to pay retirement benefit for employees who conform to retirements requirements in the next year, the Company is required to fund the difference in one appropriation that should be made before the end of March of the next year. The government is responsible for administering the defined benefit plans of the companies in Taiwan under the Labor Standards Law. The government also sets investment policies and strategies, determines investment allocation and selects investment managers. As of December 31, 2017 and 2018, the asset allocation was primarily in cash, equity securities and debt securities. Furthermore, under the Labor Standards Law, the rate of return on assets shall not be less than the average interest rate on a two-year time deposit published by the local banks. The government is responsible for any shortfall in the event that the rate of return is less than the required rate of return. However, information on how investment allocation decisions are made, inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period and significant concentrations of risk within plan assets is not fully made available to the Company by the government. Therefore, the Company is unable to provide the required fair value disclosures related to pension plan assets. Future contributions will be based on 2% of the employee salaries at that time. The Company estimates its contribution for the year ending December 31, 2019 to be US\$67 thousand which was determined based on 2% of estimated salaries in 2019.

Starting in 2010, the Company provides a defined benefit pension plan to employees of FCI in Korea with at least one year of service. FCI's overall investment strategy is to avoid a loss on plan assets. FCI estimates its contribution for the year ending December 31, 2019 to be nil.

For employees under defined contribution pension plans, pension costs are recorded based on the actual contributions made to employees' individual pension accounts. For employees under defined benefit pension plans, pension costs are recorded based on actuarial calculations. Determining the cost associated with such benefits is dependent on various actuarial assumptions, including discount rate, expected return on plan assets, compensation increase, employee mortality and turnover rates. The Company reviewed its actuarial assumptions at the measurement date on December 31 every year. The effect of modifications to assumptions is recorded in accumulated other comprehensive loss and amortized to net periodic cost over future periods using the corridor method. The Company believes that assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions. Independent actuaries perform the required calculations to determine expense in accordance with U.S. GAAP. Actual results may differ from the actuarial assumptions and are generally accumulated and amortized into earnings over future periods. The net periodic costs are recognized as employees render the services necessary to earn the benefits.

The changes in benefits obligation and plan assets and the reconciliation of funded status are as follows:

	December 31		
	2016	2017	2018
	US\$	US\$	US\$
Change in benefit obligation			
Projected benefit obligation at beginning of year	3,632	4,242	5,131
Service cost	487	1,572	568
Interest cost	104	336	126
Actuarial loss (gain)	151	(665)	146
Benefits paid	(132)	(354)	(133)
Projected benefit obligation at end of year	<u>4,242</u>	<u>5,131</u>	<u>5,838</u>
Change in plan assets			
Fair value of plan assets at beginning of year	2,800	3,902	5,114
Actual return on plan assets	33	81	63
Employer contributions	1,203	1,358	331
Benefits paid	(134)	(227)	(98)
Fair value of plan assets at end of year	<u>3,902</u>	<u>5,114</u>	<u>5,410</u>
Funded status recognized as an other liabilities	<u>(340)</u>	<u>(17)</u>	<u>(428)</u>

Amounts recognized in accumulated other comprehensive income consist of the following:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Net loss	<u>963</u>	<u>678</u>	<u>678</u>
Total recognized in accumulated other comprehensive income	<u>963</u>	<u>678</u>	<u>678</u>

The accumulated benefit obligation for all defined benefit pension plans was US\$2,648 thousand, US\$ 3,210 thousand and US\$ 3,864 thousand at December 31, 2016, 2017 and 2018, respectively.

The components of net periodic benefit cost are as follows:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Service cost	487	1,572	568
Interest cost	104	336	126
Projected return on plan assets	(28)	(58)	(78)
Amortization of unrecognized net transition obligation and unrecognized net actuarial gain	11	37	41
Net periodic benefit cost	<u>574</u>	<u>1,887</u>	<u>657</u>

Other changes in plan assets and benefit obligation recognized in other comprehensive loss:

	2016	2017	2018
	US\$	US\$	US\$
	Recognize the decrease in net gain (loss)	111	(285)
Amortization of net loss	(1)	—	—
Total recognized in other comprehensive loss (income) . . .	<u>110</u>	<u>(285)</u>	<u>—</u>

The estimated net gain for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is US\$38 thousand.

Expected benefit payments:

	US\$
2019	14
2020	5
2021	74
2022	27
2023	19
2024 and thereafter	356

The aforementioned expected benefit payments excluded FCI since the board of directors of the Company approved a sale of FCI in January 2019. Please refer to Note 23 Subsequent Events.

The actuarial assumptions to determine the benefit obligations were as follows:

	<u>2016</u>		<u>2017</u>		<u>2018</u>	
	<u>Taiwan</u>	<u>Korea</u>	<u>Taiwan</u>	<u>Korea</u>	<u>Taiwan</u>	<u>Korea</u>
Weighted-average assumptions used to determine benefit obligations:						
Discount rate	1.50%	3.80%	1.63%	4.10%	1.38%	3.60%
Rate of compensation increase	4.25%	3.50%	4.25%	3.50%	4.25%	3.00%
Weighted-average assumptions used to determine net projected benefit cost:						
Discount rate	1.50%	3.80%	1.63%	4.10%	1.38%	3.60%
Expected long-term return on plan assets	2.00%	1.10%	1.75%	1.10%	1.75%	1.40%
Rate of compensation increase	4.25%	3.50%	4.25%	3.50%	4.25%	3.00%

In 2017 and 2018, FCI's pension plan assets were invested in principal guaranteed interest insurance contracts and fixed bank deposits, which are principal and interest guaranteed products and are classified as Level 2. These Level 2 securities were valued by discounting future cash flows using benchmark yield rates.

The fair values of FCI's pension plan assets at December 31, 2017 and 2018 are as follows:

	<u>December 31</u>	
	<u>2017</u>	<u>2018</u>
	<u>US\$</u>	<u>US\$</u>
Guaranteed interest contract		
Kyobo Life Insurance Co. Ltd.	1,599	1,605
Shinhan Investment Co.	374	466
Fixed deposit		
Industrial Bank of Korea	<u>1,892</u>	<u>2,014</u>
	<u>3,865</u>	<u>4,085</u>

16. INCOME TAXES

The components of income tax expense are as follows:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Current	31,063	23,465	13,455
Deferred	(3,373)	581	(1,664)
Income tax expense	<u>27,690</u>	<u>24,046</u>	<u>11,791</u>

The income (loss) before income taxes for domestic and foreign entities is as follows:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Domestic	(20,663)	(27,902)	(23,750)
Foreign	<u>159,293</u>	<u>126,903</u>	<u>133,611</u>
	<u>138,630</u>	<u>99,001</u>	<u>109,861</u>

Since the Company is an entity of the Cayman Islands, a British overseas territory with no corporate income tax, tax on pretax income is calculated at the Cayman Islands statutory rate of zero for each year.

The Company and its subsidiaries file separate income tax returns. A reconciliation of income tax expense on pretax income at statutory rate and income tax expense is shown below:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Tax expense at statutory rate of Cayman	—	—	—
Differences between Cayman and foreign statutory tax rates	34,415	24,255	12,509
Tax-exempt income	(4,648)	—	—
Permanent differences	(7,792)	(4,249)	(703)
Temporary differences	(1,533)	(1,445)	(159)
Alternative minimum tax	594	4	9
Income tax on undistributed earnings	5,677	2,709	408
Net changes in income tax credit	(495)	166	116
Net changes in valuation allowance of deferred income tax assets	1,724	(2,401)	1,243
Net operating loss carryforwards	(1,689)	1,492	(1,431)
Liabilities related to unrealized tax benefits	2,385	3,455	(302)
Adjustment of prior years' taxes and others	(948)	60	101
Income tax expense	<u>27,690</u>	<u>24,046</u>	<u>11,791</u>

Deferred income tax assets (liabilities) are as follows:

	December 31	
	2017	2018
	US\$	US\$
Notes and accounts receivable	44	47
Stock-based compensation	771	2,103
Allowance for sales return	154	210
Inventory reserve	1,311	1,283
Foreign currency translation	(5)	(8)
Property and equipment	168	(52)
Investment tax credits	9,078	8,684
Net operating loss carryforwards	10,391	11,895
Others	562	945
Valuation allowance	<u>(19,072)</u>	<u>(20,041)</u>
	<u>3,402</u>	<u>5,066</u>

The valuation allowance shown in the table above relates to net operating loss carryforwards, tax credits and temporary differences for which the Company believes that realization is uncertain. Valuation allowance increased by US\$1,792 thousand and US\$969 thousand for the year ended December 31, 2016 and 2018, respectively, and decreased by US\$1,764 thousand for the year ended December 31, 2017. The increase in valuation allowance in 2016 and 2018 are primarily due to the uncertainty in generating sufficient taxable income in the future and utilization of operating loss carryforwards and research and development credits before they expire. The decrease in valuation allowance in 2017 was primarily due to the lower Federal corporate income tax rate that followed the enactment of the Tax Cuts and Jobs Act of 2017.

Starting from 2018 the corporate income tax rate in Taiwan increased from 17% to 20%. In addition, the rate of the corporate surtax applicable to 2018 unappropriated earnings was reduced from 10% to 5%.

As of December 31, 2018, FCI had unused research and development tax credits of approximately US\$4,069 thousand which will expire in the period from 2019 to 2023.

As of December 31, 2018, the Company's U.S. federal net operating loss carryforwards for federal income tax purposes were approximately US\$8,574 thousand. If not utilized, the federal net operating loss carryforwards will expire in 2038.

As of December 31, 2018, the Company's U.S. federal and California research and development tax credit carryforwards for federal and state income tax purposes were approximately US\$2,636 thousand and US\$1,834 thousand, respectively. If not utilized, the federal tax credit carryforwards will expire starting in 2038 while the state tax credit carryforward has no expiration date.

Current U.S. federal and California state laws include substantial restrictions on the utilization of net operating losses and credits in the event of an "ownership change" of a corporation. Accordingly, the Company's ability to utilize net operating loss and tax credit carryforwards may be limited as a result of such "ownership change". Such a limitation could result in the expiration of carryforwards before they are utilized.

As of December 31, 2018, the Company had accumulated undistributed earnings from foreign subsidiaries of US\$337 million. No deferred tax liability was recorded in respect of those amounts as these earnings are considered indefinitely reinvested. It is not practicable to estimate the amount of unrecognized deferred tax liabilities for these undistributed foreign earnings.

Unrecognized Tax Benefits

A reconciliation of the beginning and ending balances of the total amounts of unrecognized tax benefits is as follows:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Balance, beginning of year	5,639	10,286	15,056
Increases in tax positions taken in current year	4,675	6,647	5,937
Decrease in tax position taken in prior year primarily related to the resolution of tax audit	(28)	(1,877)	(2,286)
Balance, end of year	<u>10,286</u>	<u>15,056</u>	<u>18,707</u>

At December 31, 2018, the Company had US\$18,707 thousand of unrecognized tax benefits that if recognized would affect the effective tax rate. For the years ended December 31, 2016, 2017 and 2018, the total amount of interest expense and penalties related to uncertain tax positions recorded in the provision for income tax expense was approximately US\$575 thousand, US\$617 thousand and US\$776 thousand, respectively. The total amount of accrued interest and penalties recognized as of December 31, 2017 and 2018 was US\$3,421 thousand and US\$4,091 thousand, respectively. The Company does not expect uncertain tax positions to change in the next twelve months, except in the case of settlements with tax authorities, the likelihood and timing of which are difficult to estimate.

The Company files income tax returns in United States and foreign jurisdictions. The following table summarizes the Company's major jurisdictions and tax year that remain subject to examination by tax authorities as of December 31, 2018:

<u>Tax Jurisdiction</u>	<u>Tax Years</u>
China	2015 and onward
Hong Kong	2015 and onward
Taiwan	2013 and onward
Korea	2013 and onward
United States	2013 onward

17. SHAREHOLDERS' EQUITY

Dividends

The Company declared cash dividends per ordinary share during the periods presented as follows:

	2016		2017		2018	
	Dividends Per Share (US\$)	Dividends Per Share (US\$)	Dividends Per Share (US\$)	Dividends Per Share (US\$)	Dividends Per Share (US\$)	Dividends Per Share (US\$)
First quarter	\$0.0375	\$ 5,290	\$0.050	\$ 7,134	\$0.075	\$10,832
Second quarter	\$0.0375	5,290	\$0.050	7,148	\$0.075	10,835
Third quarter	\$0.0375	5,297	\$0.050	7,155	\$0.075	10,843
Fourth quarter	\$0.0500	7,065	\$0.075	10,737	\$0.075	10,849
		<u>\$22,942</u>		<u>\$32,174</u>		<u>\$43,359</u>

Beginning on November 2, 2015, the board of directors, instead of declaring a quarterly dividend, declared an annual dividend of \$0.60, equivalent to \$0.15 per ordinary shares, payable in four quarterly installments. The board of directors declared annual dividends of \$0.80, \$1.20 and \$1.20, equivalent to \$0.20, \$0.30 and \$0.30 per common share, payable in four quarterly installments on October 24, 2016, October 24, 2017 and October 29,

2018, respectively. Future dividends, if any, will be declared by and subject to the discretion of the Company's board of directors. If the Company's board of directors decides to distribute dividends, the form, frequency and amount of such dividends will depend upon the Company's future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors the board of directors may deem relevant.

Any future dividend the Company declares will be paid to the holders of ADSs, subject to the terms of the depositary agreement, to the same extent as holders of the Company's ordinary shares, to the extent permitted by applicable laws and regulations, less the fees and expenses payable under the deposit agreement. Any dividend the Company declares will be distributed by the depositary bank to the holders of our ADSs. Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars.

Treasury Stock

On November 21, 2018, the board of directors of the Company approved share buyback plans to repurchase up to US\$200 million of the Company's ADSs over a 24 month period. The program did not obligate the Company to acquire any particular amount of ADS and the program may be modified or suspended at any time at the Company's discretion. As of December 31, 2018, the Company repurchased 1,006 thousand ADSs for a total cost of US\$34.8 million. The weighted average purchase price per ADS repurchased was US\$34.54.

18. EQUITY INCENTIVE PLAN

2005 Equity Incentive Plan and 2015 Equity Incentive Plan

On April 22, 2005, the Company adopted its 2005 Equity Incentive Plan ("the 2005 Plan"). The 2005 Plan provides for the grant of stock options, stock bonuses, restricted stock awards, restricted stock units and stock appreciation rights, which may be granted to employees (including officers), directors and consultants. The 2005 Plan reserved 10,000 thousand shares of ordinary shares, inclusive of the number of assumed share options under the 2004 Plan, for issuance upon the exercise of stock options.

In 2006, the Company amended the 2005 Plan to reserve an additional 15,000 thousand ordinary shares for issuance upon exercise of stock options and restricted stock units. In 2009, the Company amended the Plan to reserve an additional 15,000 thousand ordinary shares for issuance upon exercise of stock options and restricted stock units.

Restricted stock units are converted into shares of the Company's ordinary shares upon vesting on one-for-one basis. The vesting of restricted stock unit is subject to the employee's continuing service to the Company. The cost of these awards is determined using the fair value of the Company's ordinary share on the date of the grant, and compensation is recognized on a straight-line basis over the requisite service period. The Company's restricted stock units are considered non-vested share awards as defined under ASC 718.

In April 2010, the Company's Board of Directors and Compensation Committee approved an employee stock option exchange program that required certain employees to exchange eligible stock options for a lesser number of new stock options that have approximately the same fair values as the options surrendered. Eligible options included stock options granted between August 17, 2005 and July 31, 2008 that had an exercised price above US\$1.85. In 2010, 4,369 thousand eligible stock options were exchanged for 3,785 thousand new stock options granted. The new stock options have an exercise price of US\$1.47, which was equal to the market price of the Company's ordinary share on April 26, 2010, the date eligible stock options were surrendered and new stock options granted. The new stock options were issued under the 2005 Plan and are subject to its terms and conditions. The new stock options will continue to vest according to the original vesting schedule. Using the Black-Scholes option pricing model, the Company determined that the fair value of the surrendered stock options on a grant-by-grant basis was approximately equal, as of the date of the exchange, to the fair value of the new stock options granted, resulting in insignificant incremental share-based compensation.

On June 3, 2015, the Company adopted its 2015 Equity Incentive Plan (“the 2015 Plan”). The 2015 Plan provides for the grant of stock options, stock bonuses, restricted stock awards, restricted stock units and stock appreciation rights, which may be granted to employees (including officers), directors and consultants. The 2015 Plan reserved 20,000 thousand shares of ordinary shares for issuance upon exercise of stock options and restricted stock units.

Stock Option and Restricted Stock Units Activity

The following is a summary of, the 2005 Plan and the 2015 Plan, which includes stock options and restricted stock units:

	<u>Unit</u> <u>(in Thousands)</u>
Available for grant at January 1, 2016	19,862
Restricted stock units granted	(1,446)
Option and restricted stock units forfeited	<u>335</u>
Available for grant at December 31, 2016	18,751
Restricted stock units granted	(1,391)
Option and restricted stock units forfeited	<u>27</u>
Available for grant at December 31, 2017	17,387
Restricted stock units granted	(1,622)
Option and restricted stock units forfeited	<u>22</u>
Available for grant at December 31, 2018	<u><u>15,787</u></u>

Stock Options

A summary of the stock option activity and related information is as follows:

	<u>Number of</u> <u>Options</u> <u>Shares</u> <u>(in Thousands)</u>	<u>Weighted</u> <u>Average</u> <u>Exercise</u> <u>Price</u> <u>(US\$)</u>	<u>Weighted</u> <u>Average</u> <u>Remaining</u> <u>Contractual</u> <u>Life</u> <u>(Years)</u>
Outstanding at January 1, 2016	579	1.47	
Options forfeited	(257)	1.47	
Options exercised	<u>(64)</u>	<u>1.47</u>	
Outstanding at December 31, 2016	<u>258</u>	<u>1.47</u>	0.25
Options vested and expected to vest after			
December 31, 2016	258	1.47	0.25
Options exercised	<u>(258)</u>	<u>1.47</u>	
Outstanding at December 31, 2017	<u>—</u>	<u>—</u>	—

No stock options were granted in 2016, 2017 and 2018. The intrinsic value of options exercised, determined as of the date of option exercise, was US\$580 thousand, US\$3,040 thousand and nil in 2016, 2017 and 2018, respectively.

As of December 31, 2018, total unrecognized compensation cost related to non-vested share-based compensation awards granted under the Company’s stock option plans, net of estimated forfeitures, was nil.

The aggregate intrinsic value represents the total intrinsic value (the difference between the Company’s closing stock price on the last trading day of fiscal year 2018 and the exercise price, multiplied by the number of

in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2018. Intrinsic value will change in future periods based on the fair market value of the Company's stock and the number of shares outstanding.

The total cash received from employees as a result of employee stock option exercises were US\$93 thousand, US\$380 thousand and nil for the years ended December 31, 2016, 2017 and 2018, respectively.

The related tax effect for stock-based compensation benefit were US\$37 thousand, US\$124 thousand and US\$177 thousand for 2016, 2017 and 2018, respectively. The related tax effect for stock-based compensation expense for option and restricted stock units exercised during 2016, 2017 and 2018 was US\$1,702 thousand, US\$2,273 thousand and US\$2,196 thousand, respectively. The related tax effect was determined using the applicable tax rates in jurisdictions to which this expense relates.

Restricted Stock Units

A summary of the status of restricted stock units and changes is as follows:

	Number of Non-vested Stock Units (in Thousands)	Weighted Average Grant Date Fair Value (US\$)	Weight Average Remaining Recognition Period (Years)
Non-vested at January 1, 2016	2,125	6.65	0.73
Restricted stock units granted	1,446	12.67	
Restricted stock units vested	(1,726)	6.46	
Restricted stock units forfeited	(78)	6.57	
Non-vested at December 31, 2016	1,767	11.65	0.47
Restricted stock units granted	1,391	10.75	
Restricted stock units vested	(1,593)	12.08	
Restricted stock units forfeited	(27)	10.69	
Non-vested at December 31, 2017	1,538	10.36	0.33
Restricted stock units granted	1,622	13.86	
Restricted stock units vested	(1,517)	9.79	
Restricted stock units forfeited	(22)	11.75	
Non-vested at December 31, 2018	1,621	13.85	0.38

As of December 31, 2018, there was US\$6,162 thousand of total unrecognized compensation cost related to restricted stock units granted under the 2015 Plan.

Stock-based Compensation Expense

The following table shows total stock-based compensation expense included in the Consolidated Statements of Income for the years ended December 31, 2016, 2017 and 2018.

	Year Ended December 31		
	2016 US\$	2017 US\$	2018 US\$
Cost of sales	400	293	390
Research and development	10,529	9,255	13,278
Sales and marketing	3,122	3,167	3,407
General and administrative	3,313	2,779	3,704
	<u>17,364</u>	<u>15,494</u>	<u>20,779</u>

19. COMMITMENTS AND CONTINGENCIES

FCI provided their employees with collateral for personal loans which is deposited at a designated bank and the amount deposited was US\$468 thousand and US\$448 thousand at December 31, 2017 and 2018, respectively. Such amounts were accounted for as restricted cash.

Operating Leases

The Company entered into various operating lease agreements for office space that expire on various dates through March 2022. The Company recognized rent expense for the years ended December 31, 2016, 2017 and 2018 of US\$2,595 thousand, US\$3,131 thousand and US\$3,933 thousand, respectively. The minimum operating lease payments expected under these leases as of December 31, 2018 were US\$2,802 thousand, US\$1,757 thousand, US\$1,263 thousand, US\$65 thousand, and nil for the years ending December 31, 2019, 2020, 2021, 2022 and 2023, respectively.

Litigation

The Company is subject to legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. Although the outcome of such proceedings and claims cannot be predicted with certainty, management does not believe that the outcome of any of these matters will have a material adverse effect on our business, results of operations, financial position or cash flows. Any litigation, however, involves potential risk and potentially significant litigation costs, and therefore there can be no assurance that any litigation which is now pending or which may arise in the future would not have such a material adverse effect on our business, financial position, results of operations or cash flows.

All American Semiconductor, Inc. (“All American” or “AASI”) was a former distributor for the Company. On April 25, 2007, All American filed for Chapter 11 bankruptcy protection. At the time of the filing, the Company had US\$256 thousand of unpaid accounts receivable from All American. On April 17, 2009 SMI USA and related entities were named as defendants in an adversary proceeding filed by the AASI Creditor Liquidating Trust (“CLT”) in the bankruptcy case pending in the U.S. Bankruptcy Court for the Southern District of Florida. The CLT was seeking the return of allegedly avoidable transfers in the amount of US\$854 thousand. SMI USA filed an answer and affirmative defenses. In March 2010, SMI USA settled with the CLT by paying the amount of US\$220 thousand and on April 1, 2010, the Bankruptcy Court granted the motion to approve stipulations to compromise controversy. On August 23, 2010, the Court entered an order dismissing the adversary proceeding. In June 2011, Liquidating Trustee for the CLT filed the AASI Creditor Liquidating Trustee’s Seventeenth Omnibus Objection to Claims but in August 2011, withdrew it with respect to SMI USA’s proof of claim. As a holder of allowed claims, we are entitled to receive distribution pursuant to the bankruptcy plan. On December 31, 2017, we received total distributions of US\$265 thousand from the CLT and this case is officially closed.

20. SEGMENT INFORMATION

The Company is the global leader in selling NAND flash controllers for solid state storage devices. The Company currently operates as one reportable segment. The chief operating decision maker is the Chief Executive Officer.

The Company groups its products into three categories, based on the markets in which they may be used. The following summarizes the Company's revenue by markets:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Mobile Storage	510,687	480,735	494,012
Mobile Communications	39,322	37,447	30,163
Others	<u>6,137</u>	<u>5,222</u>	<u>6,173</u>
	<u>556,146</u>	<u>523,404</u>	<u>530,348</u>

Revenue is attributed to a geographic area based on the bill-to location. The following summarizes the Company's revenue by geographic area:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Taiwan	75,926	72,768	70,984
United States	59,390	40,344	53,476
Japan	17,070	18,797	21,171
Korea	183,249	176,813	135,845
China	151,112	126,048	142,948
Others	<u>69,399</u>	<u>88,634</u>	<u>105,924</u>
	<u>556,146</u>	<u>523,404</u>	<u>530,348</u>

Major customers representing at least 10% of net sales

	Year Ended December 31					
	2016		2017		2018	
	US\$	%	US\$	%	US\$	%
SK Hynix	156,541	28	150,762	29	111,265	21
Intel	*	*	50,205	10	67,791	13

* Less than 10%

Long-lived assets (property and equipment, net) by geographic area were as follows:

	Year Ended December 31		
	2016	2017	2018
	US\$	US\$	US\$
Taiwan	34,011	36,369	96,920
United States	237	242	348
Korea	1,448	1,936	1,645
China	12,181	12,798	2,447
Japan	15	25	50
	<u>47,892</u>	<u>51,370</u>	<u>101,410</u>

21. FAIR VALUE MEASUREMENT

The following section describes the valuation methodologies the Company uses to measure assets and liabilities at fair value.

The Company uses quoted prices in active markets for identical assets to determine fair value where applicable. This pricing methodology applies to Level 1 investments such as bond funds. The fair value of the principal protected notes was determined by its present value utilizing rate of return as the market observable input and therefore, these are classified as Level 2 instruments. This is because there generally are no quoted prices in active markets for identical principal protected notes at the reporting date. Hence, in order to determine the fair value, the Company must use observable inputs other than quoted prices in active markets for identical or similar instruments, quoted prices for similar instruments in active markets, or other inputs that are observable.

For the years ended December 31, 2017 and 2018, none of the Company's assets measured on a recurring basis was determined by using significant unobservable inputs.

The following table presents our assets measured at fair value on a recurring basis as of December 31, 2017 and 2018:

December 31, 2017

	<u>Level 1</u> US\$	<u>Level 2</u> US\$	<u>Level 3</u> US\$	<u>Total</u> US\$
Assets				
Short-term investments — trading securities	755	6,186	—	6,941

December 31, 2018

	<u>Level 1</u> US\$	<u>Level 2</u> US\$	<u>Level 3</u> US\$	<u>Total</u> US\$
Assets				
Short-term investments — trading securities	—	3,609	—	3,609

22. RELATED PARTY TRANSACTIONS

Lease support arrangements, known in Korea as Jeonse, were in place for certain Korean employees, primarily executive officers. These arrangements, in place from 2007 to 2019, consisted of a program which the Company facilitated housing arrangements by depositing funds with lessors who are either third parties, employees or relatives of the employees. Such funds would serve to establish the leasehold interest for the employees. When such arrangements are finished, the Company receives the deposited funds back in full. The deposited amount of these arrangements for such employees was US\$1.6 million and US\$1.5 million as of December 31, 2017 and 2018, respectively.

23. SUBSEQUENT EVENTS

a) *Sale of FCI*

In January 2019, the board of directors of the Company approved the sale of FCI, our specialty RF IC product line for the Mobile Communications market. On March 7, 2019, the Company entered into a definitive agreement with Dialog Semiconductor Plc for the sale of FCI for US\$45 million. The transaction is expected to close in the second quarter of 2019, subject to Korea government approvals.

b) *Sale of ProGrade investment*

In April 2019, the board of directors approved the sale of the Company's 49.0% equity interest in ProGrade for \$1.7 million. The sale is expected to close in the second quarter of 2019.

c) *Shannon Impairment Risk*

In April 2019, key customers of our Shannon SSDs notified the Company that their revised full-year 2019 procurement forecasts will be significantly lower than what they had provided to us in January 2019. As a result,

we reduced our Shannon SSD sales forecast to a level meaningfully below what we had planned in January as part of our annual operating plan. The primary reasons of the recently reduced sales forecast include: (i) increasingly risk-adverse customers have reduced procurement plans relating to SSD solutions based on new, less mature technologies such as ours, (ii) weakening economic conditions in China have caused Chinese data center operators to postpone expansion plans and reduce SSD procurement forecasts, including from us, and (iii) NAND prices have fallen more than we had expected and could fall further, and this will result in less revenue received for the same petabyte of Shannon SSDs that we sell.

The reduced sales forecast represents a triggering event which will require the reevaluation of the reporting unit's goodwill and intangible assets in the second quarter of 2019. Depending on further development of the situation and factors relevant to a revised financial forecast of the Shannon reporting unit, the impairment assessment may result in impairment of goodwill and of certain intangible assets; however, the Company cannot estimate the amount or a reasonable range of amounts of such impairments, if any, at this time. As of December 31, 2018, the carrying value of the reporting unit's goodwill was \$33.2 million and intangible assets were \$1.0 million.

Subsidiaries of Silicon Motion Technology Corporation

<u>Name of Entity</u>	<u>Jurisdiction of Incorporation</u>
Bigtera (Beijing)	China
Shannon Systems	China
Silicon Motion, Inc.	California
Silicon Motion, Inc.	Taiwan
Silicon Motion, Inc. (Shanghai)	China
Silicon Motion, Inc. (Shenzhen)	China
Silicon Motion (MCO) Ltd.	Macau
Silicon Motion Technology (HK) Ltd.	Hong Kong
FCI Inc.*	Korea

* See “Subsequent Events”.

**Certification by the Chief Executive Officer Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Wallace C. Kou, certify that:

1. I have reviewed this annual report on Form 20-F of Silicon Motion Technology Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of company's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: May 15, 2019

/s/ Wallace C. Kou

Name: Wallace C. Kou

Title: President and Chief Executive Officer

**Certification by the Chief Financial Officer Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Riyadh Lai, certify that:

1. I have reviewed this annual report on Form 20-F of Silicon Motion Technology Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of company's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: May 15, 2019

/s/ Riyadh Lai

Name: Riyadh Lai

Title: Chief Financial Officer

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

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned each hereby certifies that, to his knowledge, the annual report on Form 20-F of Silicon Motion Technology Corporation for the year ended December 31, 2018 fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and that the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of Silicon Motion Technology Corporation.

The foregoing certification is being furnished pursuant to 18 U.S.C. Section 1350 solely for purposes of complying with the provisions of Section 906 of the Sarbanes-Oxley Act of 2002, is not intended to be used or relied upon for any other purpose and is not being filed as part of the periodic report or as a separate disclosure document.

Date: May 15, 2019

/s/ Wallace C. Kou

Name: Wallace C. Kou

Title: President and Chief Executive Officer

/s/ Riyadh Lai

Name: Riyadh Lai

Title: Chief Financial Officer

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-161599, 333-142422, 333-131219 and 333-204876 on Forms S-8 of our reports dated May 15, 2019, relating to the consolidated financial statements of Silicon Motion Technology Corporation and subsidiaries (which report expresses an unqualified opinion) and the effectiveness of Silicon Motion Technology Corporation and subsidiaries' internal control over financial reporting, appearing in the Annual Report on Form 20-F of Silicon Motion Technology Corporation for the year ended December 31, 2018.

/s/ Deloitte & Touche
Taipei, Taiwan
The Republic of China

May 15, 2019

Board of Directors

- **James Chow**
Chairman of the Board
Silicon Motion Technology Corp.
- **Wallace C. Kou**
President & Chief Executive Officer
Silicon Motion Technology Corp.
- **Steve Chen**
Chairman
Mercuries Co., Ltd.
- **Tsung-Ming Chung**
Chairman
Dynapack International Technology Corp.
- **Lien-Chun Liu**
Research Fellow
Taiwan Research Institute
- **Yung-Chien Wang**
Vice President
Professional Trust Co., Ltd.
- **Han-Ping D. Shieh**
Professor
National Chiao Tung University's Display Institute and
Department of Photonics
- **Kenneth Kuan-Ming Lin**
Chairman
Premier Capital Management Corp.
- **Nelson Duann**
Senior VP of Marketing & R&D
Silicon Motion Technology Corp.

ADS Listing

Our American Depositary Shares (ADSs) trade on the NASDAQ Global Select Market under the symbol "SIMO"

ADS Depository

The Bank of New York Mellon, New York, NY

Investor Relations

For more information about Silicon Motion, please visit our website at www.siliconmotion.com or e-mail us at ir@siliconmotion.com

Executive Officers

- **Wallace C. Kou**
President & Chief Executive Officer
- **Riyadh Lai**
Chief Financial Officer
- **Nelson Duann**
Senior VP of Marketing & R&D
- **Xueshi Yang**
Senior VP and General Manager, Shannon Systems
- **Arthur Yeh**
VP of Sales
- **Robert Fan**
President of SMI USA
- **David Yu**
VP of Sales & Marketing, Shannon Systems
- **Leander Yu**
VP of Sales & Marketing, Bigtera
- **Ken Chen**
VP of Operations
- **Kevin Yeh**
VP of R&D, Algorithm & Technology
- **Frank Shu**
VP of R&D, Verification Engineering & Compatibility Test
- **Mike Jing**
VP of IT

Independent Auditors

Deloitte & Touche, Taipei, Taiwan

Legal Counsel

K&L Gates, Taipei, Taiwan

