

SemiLEDs Corp  
Form 10-Q  
July 12, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**For the quarterly period ended May 31, 2013**

**or**

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

**For the transition period from            to**

**Commission File Number: 001-34992**

**SemiLEDs Corporation**

(Exact name of registrant as specified in its charter)

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**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-2735523**

(I.R.S. Employer  
Identification Number)

**3F, No. 11 Ke Jung Rd., Chu-Nan Site,  
Hsinchu Science Park, Chu-Nan 350,  
Miao-Li County, Taiwan, R.O.C.**

(Address of principal executive offices)

**350**

(Zip Code)

**+886-37-586788**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 27,760,780 shares of common stock, par value \$0.0000056 per share, outstanding as of July 5, 2013.

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**SEMILEDS CORPORATION**

**FORM 10-Q for the Quarter Ended May 31, 2013**

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****SEMILEDS CORPORATION****Unaudited Condensed Consolidated Balance Sheets****(In thousands of U.S. dollars and shares, except par value)**

	May 31, 2013	August 31, 2012
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 41,367	\$ 47,228
Short-term investments		8,831
Accounts receivable, net of allowance for doubtful accounts of \$1,364 and \$577 as of May 31, 2013 and August 31, 2012, respectively	2,541	4,759
Accounts receivable from related parties, net of allowance for doubtful accounts of \$1,388 and \$1,405 as of May 31, 2013 and August 31, 2012, respectively	83	157
Inventories	9,511	13,016
Prepaid expenses and other current assets	1,305	1,130
Total current assets	54,807	75,121
Property, plant and equipment, net	41,904	46,642
Intangible assets, net	705	1,552
Goodwill		1,072
Investments in unconsolidated entities	2,357	1,821
Other assets	1,363	1,326
<b>TOTAL ASSETS</b>	<b>\$ 101,136</b>	<b>\$ 127,534</b>
<b>LIABILITIES AND EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Notes payable to banks	\$	\$ 1,585
Current installments of long-term debt	1,917	967
Accounts payable	4,581	5,768
Accrued expenses and other current liabilities	4,383	4,969
Deferred income, current portion	51	51
Total current liabilities	10,932	13,340
Long-term debt, excluding current installments	5,922	4,953
Deferred income, net of current portion	352	390
Total liabilities	17,206	18,683
Commitments and contingencies (Note 6)		
<b>EQUITY:</b>		
SemiLEDs stockholders' equity		
Common stock, \$0.0000056 par value 32,143 shares authorized; 27,752 shares and 27,470 shares issued and outstanding as of May 31, 2013 and August 31, 2012, respectively		
Additional paid-in capital	168,591	167,070
Accumulated other comprehensive income	5,565	5,179
Accumulated deficit	(90,298)	(64,431)

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Total SemiLEDs stockholders' equity	83,858	107,818
Noncontrolling interests	72	1,033
Total equity	83,930	108,851
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 101,136</b>	<b>\$ 127,534</b>

See notes to unaudited condensed consolidated financial statements.

Table of Contents**SEMILEDS CORPORATION****Unaudited Condensed Consolidated Statements of Operations****(In thousands of U.S. dollars and shares, except per share data)**

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2013	2012	2013	2012
Revenues, net	\$ 3,526	\$ 9,178	\$ 14,583	\$ 23,830
Cost of revenues	8,083	10,232	25,781	26,428
Gross loss	(4,557)	(1,054)	(11,198)	(2,598)
Operating expenses:				
Research and development	1,146	2,223	3,403	5,935
Selling, general and administrative	2,171	3,205	8,454	10,155
Goodwill impairment loss (Note 3)	1,077		1,077	
Impairment of long-lived assets (Note 3)	851		851	
Provision for litigation settlement (Note 6)		1,500		1,500
Total operating expenses	5,245	6,928	13,785	17,590
Loss from operations	(9,802)	(7,982)	(24,983)	(20,188)
Other income (expenses):				
Impairment loss on investment (Note 4)	(1,885)		(1,885)	
Equity in losses from unconsolidated entities, net	(74)	(2,173)	(172)	(4,875)
Interest income (expenses), net	(25)	(6)	9	10
Other income, net	52	49	158	144
Foreign currency transaction gain (loss), net	350	10	190	(338)
Total other expenses, net	(1,582)	(2,120)	(1,700)	(5,059)
Loss before income taxes	(11,384)	(10,102)	(26,683)	(25,247)
Income tax expense			3	
Net loss	(11,384)	(10,102)	(26,686)	(25,247)
Less: Net loss attributable to noncontrolling interests	(431)	(99)	(819)	(409)
Net loss attributable to SemiLEDs stockholders	\$ (10,953)	\$ (10,003)	\$ (25,867)	\$ (24,838)
Net loss attributable to SemiLEDs common stockholders:				
Basic and diluted	\$ (10,953)	\$ (10,003)	\$ (25,867)	\$ (24,838)
Net loss per share attributable to SemiLEDs common stockholders:				
Basic and diluted	\$ (0.40)	\$ (0.36)	\$ (0.94)	\$ (0.91)
Shares used in computing net loss per share attributable to SemiLEDs common stockholders:				
Basic and diluted	27,710	27,481	27,579	27,389

See notes to unaudited condensed consolidated financial statements.

Table of Contents**SEMILEDS CORPORATION****Unaudited Condensed Consolidated Statements of Comprehensive Loss****(In thousands of U.S. dollars)**

	<b>Three Months Ended May 31,</b>		<b>Nine Months Ended May 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net loss	\$ (11,384)	\$ (10,102)	\$ (26,686)	\$ (25,247)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	(644)	(1,205)	396	(1,528)
Total comprehensive loss	(12,028)	(11,307)	(26,290)	(26,775)
Less: Net loss attributable to noncontrolling interests	(431)	(99)	(819)	(409)
Less: Foreign currency translation adjustment attributable to noncontrolling interests	(4)	(18)	10	(45)
Comprehensive loss attributable to SemiLEDs stockholders	\$ (11,593)	\$ (11,190)	\$ (25,481)	\$ (26,321)

See notes to unaudited condensed consolidated financial statements.



Table of Contents**SEMILEDs CORPORATION****Unaudited Condensed Consolidated Statement of Equity**

(In thousands of U.S. dollars and shares)

	Common Stock		Additional	Accumulated	Accumulated	Total	Non-	Total
	Shares	Amount	Paid-in	Other	Deficit	SemiLEDs	Controlling	Equity
			Capital	Comprehensive		Stockholders	Interests	
				Income		Equity		
BALANCE September 1, 2012	27,470	\$	\$ 167,070	\$ 5,179	\$ (64,431)	\$ 107,818	\$ 1,033	\$ 108,851
Issuance of common stock								
under equity incentive plans	282		74			74		74
Stock-based compensation			1,497			1,497		1,497
Purchase of common shares in								
Ning Xiang from								
noncontrolling interests			(50)			(50)	(152)	(202)
Comprehensive loss:								
Foreign currency translation								
adjustment				386		386	10	396
Net loss					(25,867)	(25,867)	(819)	(26,686)
Total comprehensive loss						(25,481)	(809)	(26,290)
BALANCE May 31, 2013	27,752	\$	\$ 168,591	\$ 5,565	\$ (90,298)	\$ 83,858	\$ 72	\$ 83,930

See notes to unaudited condensed consolidated financial statements.

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## SEMILEDS CORPORATION

## Unaudited Condensed Consolidated Statements of Cash Flows

(In thousands of U.S. dollars)

	Nine Months Ended May 31,	
	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (26,686)	\$ (25,247)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	6,252	6,320
Goodwill impairment loss	1,077	
Impairment of long-lived assets	851	
Impairment loss on investment	1,885	
Stock-based compensation expense	1,497	2,114
Bad debt expense	805	
Gain on disposal of property, plant and equipment		(125)
Provisions for inventory write-downs	2,263	2,333
Equity in losses from unconsolidated entities, net	172	4,875
Income recognized on patents assignment	(38)	(38)
Changes in operating assets and liabilities:		
Accounts receivable, net	1,533	215
Inventories	1,292	(1,434)
Prepaid expenses and other	(189)	(66)
Accounts payable	209	692
Accrued expenses and other current liabilities	(724)	(176)
Net cash used in operating activities	(9,801)	(10,537)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property, plant and equipment, including interest capitalized	(2,633)	(10,351)
Sale of property, plant and equipment		171
Purchase of investment	(2,873)	
Payments for development of intangible assets	(323)	(259)
Proceeds from sale of short-term investments	8,831	
Proceeds from return of investment in unconsolidated entity	250	
Other investing activities, net	5	17
Net cash provided by (used in) investing activities	3,257	(10,422)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock options	74	68
Proceeds from line of credit		1,594
Payments on line of credit	(1,623)	(900)
Proceeds from long-term debt	2,902	
Payments of long-term debt	(951)	(710)
Proceeds from loan from related party	204	
Acquisition of noncontrolling interests	(202)	
Net cash provided by financing activities	404	52
Effect of exchange rate changes on cash and cash equivalents	279	233
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(5,861)</b>	<b>(20,674)</b>
<b>CASH AND CASH EQUIVALENTS Beginning of period</b>	<b>47,228</b>	<b>83,619</b>
<b>CASH AND CASH EQUIVALENTS End of period</b>	<b>\$ 41,367</b>	<b>\$ 62,945</b>
<b>NONCASH INVESTING AND FINANCING ACTIVITIES:</b>		
Accrual related to property, plant and equipment	\$ 1,749	\$ 2,124

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See notes to unaudited condensed consolidated financial statements.

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**SEMILEDS CORPORATION**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**1. Business**

**Business** SemiLEDs Corporation ( SemiLEDs ) was incorporated in Delaware on January 4, 2005 and is a holding company for various wholly and majority owned subsidiaries and joint ventures. SemiLEDs and its subsidiaries (collectively, the Company ) develop, manufacture and sell high performance light emitting diodes ( LEDs ). The Company s core products are LED chips and LED components, but lighting products have also become an increasingly important part of the Company s business. A portion of the Company s business consists of the sale of contract manufactured LED components. The Company s customers are concentrated in a few select markets, including China, Taiwan, Russia and the United States.

On December 8, 2010, SemiLEDs completed its initial public offering in the United States and sold 6,038 thousand new common shares. The Company s common shares are listed on the NASDAQ Global Select Market under the symbol LEDS.

As of May 31, 2013, SemiLEDs had seven wholly owned subsidiaries and a 66% equity interest in Ning Xiang Technology Co., Ltd. ( Ning Xiang ). The most significant of these consolidated subsidiaries is SemiLEDs Optoelectronics Co., Ltd. located in Hsinchu, Taiwan where a substantial portion of research, development, manufacturing, marketing and sales activities currently take place and where a substantial portion of the assets are held and located. In April 2013, SemiLEDs acquired an additional 15% of the outstanding shares of Ning Xiang, increasing its ownership interest from 51% to 66%.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation** The Company s unaudited interim condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ( U.S. GAAP ) and applicable provisions of the rules and regulations of the U.S. Securities and Exchange Commission ( SEC ) regarding interim financial reporting. Certain information and disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted as permitted by the rules and regulations of the SEC. Accordingly, these unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K filed with the SEC on December 13, 2012. The unaudited condensed consolidated balance sheet as of August 31, 2012 included herein was derived from the audited consolidated financial statements as of that date.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the Company s consolidated balance sheet as of May 31, 2013, the statements of operations and comprehensive loss for the three and nine months ended May 31, 2013 and 2012, the statement of equity for the nine months ended May 31, 2013, and the statements of cash flows for the nine months

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ended May 31, 2013 and, 2012. The results for the three or nine months ended May 31, 2013 are not necessarily indicative of the results to be expected for the year ending August 31, 2013.

**Principles of Consolidation** The unaudited interim condensed consolidated financial statements include the accounts of SemiLEDs and its consolidated subsidiaries. All intercompany transactions and balances have been eliminated during consolidation.

**Use of Estimates** The preparation of unaudited interim condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited interim condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the collectibility of accounts receivable, inventory net realizable values, realization of deferred tax assets, valuation of stock-based compensation expense, the useful lives of property, plant and equipment and intangible assets, the recoverability of the carrying amount of property, plant and equipment, intangible assets, goodwill and investments in unconsolidated entities, the fair value of acquired tangible and intangible assets, income tax uncertainties, provision for potential litigation costs and other contingencies. Management bases its estimates on historical experience and also on assumptions that it believes are reasonable. Management assesses these estimates on a regular basis; however, actual results could differ materially from those estimates.

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**Concentration of Supply Risk** Some of the components and technologies used in the Company's products are purchased and licensed from a limited number of sources and some of the Company's products are produced by a limited number of contract manufacturers. The loss of any of these suppliers and contract manufacturers may cause the Company to incur transition costs to another supplier or contract manufacturer, result in delays in the manufacturing and delivery of the Company's products, or cause it to carry excess or obsolete inventory. The Company relies on a limited number of such suppliers and contract manufacturers for the fulfillment of its customer orders. Any failure of such suppliers and contract manufacturers to perform could have an adverse effect upon the Company's reputation and its ability to distribute its products or satisfy customers' orders, which could adversely affect the Company's business, financial position, results of operations and cash flows.

**Concentration of Credit Risk** Financial instruments that subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, short-term investments and accounts receivable.

The Company keeps its cash, cash equivalents and short-term investments in demand deposits, certificates of deposit and time deposits with prominent banks of high credit quality and invests only in money market funds. Deposits held with banks may exceed the amount of insurance provided on such deposits. As of May 31, 2013 and August 31, 2012, cash, cash equivalents and short-term investments of the Company consisted of the following (in thousands):

Cash, Cash Equivalents and Short-term Investments by Location	May 31, 2013	August 31, 2012
United States:		
Denominated in U.S. dollars	\$ 18,684	\$ 18,744
Taiwan:		
Denominated in U.S. dollars	20,811	34,477
Denominated in New Taiwan dollars	958	2,193
Denominated in other currencies	221	235
China (including Hong Kong):		
Denominated in U.S. dollars	345	376
Denominated in Renminbi	347	33
Denominated in H.K. dollars	1	1
Total cash, cash equivalents and short-term investments	\$ 41,367	\$ 56,059

The Company's revenues are substantially derived from the sales of LED products. A significant portion of the Company's revenues are derived from a limited number of customers and sales are concentrated in a few select markets. Management performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable. Management evaluates the need to establish an allowance for doubtful accounts for estimated potential credit losses at each reporting period. The allowance for doubtful accounts is based on the management's assessment of the collectibility of its customer accounts. Management regularly reviews the allowance by considering certain factors, such as historical experience, industry data, credit quality, age of accounts receivable balances and current economic conditions that may affect a customer's ability to pay.

Net revenues generated from sales to the top ten customers represented 40% and 36% of the Company's net revenues for the three and nine months ended May 31, 2013, respectively, and 57% and 55% of the Company's net revenues for the three and nine months ended May 31, 2012, respectively.

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The Company's revenues have been concentrated in a few select markets, including China, Taiwan, Russia and the United States. Net revenues generated from sales to customers in these markets, in the aggregate, accounted for 65% and 63% of the Company's net revenues for the three and nine months ended May 31, 2013, respectively, and 78% and 80% of the Company's net revenues for the three and nine months ended May 31, 2012, respectively.

**Noncontrolling Interests** Noncontrolling interests arise from the acquisition of a 51% ownership interest in Ning Xiang in August 2011. Noncontrolling interests are classified in the consolidated statements of operations as part of consolidated net income (loss) and the accumulated amount of noncontrolling interests in the consolidated balance sheets as part of equity. If a change in ownership of a consolidated subsidiary results in loss of control and deconsolidation, any retained ownership interests are remeasured with the gain or loss reported in net earnings.

In April 2013, SemiLEDs acquired an additional 15% of the outstanding shares of Ning Xiang for cash consideration of \$202 thousand, increasing its ownership interest from 51% to 66%. As a result, the difference between the consideration paid and the adjustment to the carrying amount of the noncontrolling interests to reflect SemiLEDs' increased ownership interest in Ning Xiang was recorded as a reduction in additional paid-in capital. Transactions with noncontrolling interests had the following effect on equity attributable to SemiLEDs stockholders (in thousands):

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	<b>Three Months Ended May 31, 2013</b>	<b>Nine Months Ended May 31, 2013</b>
Net loss attributable to SemiLEDs stockholders	\$ (10,953)	\$ (25,867)
Transfers to noncontrolling interests:		
Decrease in SemiLEDs additional paid in capital for purchase of common shares in Ning Xiang	(50)	(50)
Change from net loss attributable to SemiLEDs stockholders and transfer to noncontrolling interests	\$ (11,003)	\$ (25,917)

**Recently Adopted Accounting Pronouncement**

**Presentation of comprehensive income** Effective on September 1, 2012, the Company adopted Financial Accounting Standards Board ( FASB ) Accounting Standards Update ( ASU ) No. 2011-05, Presentation of Comprehensive Income. ASU 2011-05 increases the prominence of other comprehensive income in the financial statements. The Company has elected to present the components of net income and comprehensive income in two separate but consecutive financial statements. The Company adopted ASU 2011-05 retrospectively for all periods presented.



Table of Contents**3. Balance Sheet Components****Inventories**

Inventories as of May 31, 2013 and August 31, 2012 consisted of the following (in thousands):

	May 31, 2013	August 31, 2012
Raw materials	\$ 2,225	\$ 2,999
Work in process	3,066	4,065
Finished goods	4,220	5,952
Total	\$ 9,511	\$ 13,016

**Property, Plant and Equipment**

Property, plant and equipment as of May 31, 2013 and August 31, 2012 consisted of the following (in thousands):

	May 31, 2013	August 31, 2012
Buildings and improvements	\$ 14,501	\$ 14,501
Machinery and equipment	64,898	64,267
Leasehold improvements	3,143	3,143
Other equipment	2,182	2,249
Construction in progress	3,005	2,546
Total property, plant and equipment	87,729	86,706
Less: Accumulated depreciation, amortization and impairment(1)	(45,825)	(40,064)
Property, plant and equipment, net	\$ 41,904	\$ 46,642

(1) Includes an impairment charge of \$7,507 thousand on certain of the Company's property, plant and equipment, which was included in the Company's consolidated statement of operations for the year ended August 31, 2012. The impairment charge was primarily related to machinery and equipment used in the manufacturing of LED chips.

**Intangible Assets**

Intangible assets as of May 31, 2013 and August 31, 2012 consisted of the following (in thousands):

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	May 31, 2013			
	Weighted Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization and Impairment	Net Carrying Amount
Patents and trademarks	16	\$ 868	\$ 198	\$ 670
Acquired technology	4	167	132	35
Customer relationships(2)	5	1,337	1,337	
Total		\$ 2,372	\$ 1,667	\$ 705

(2) Includes an impairment charge of \$851 thousand, which was included in the Company's unaudited interim condensed consolidated statement of operations for the three months ended May 31, 2013.

	August 31, 2012			
	Weighted Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patents and trademarks	17	\$ 585	\$ 146	\$ 439
Acquired technology	4	167	101	66
Customer relationships	5	1,337	290	1,047
Total		\$ 2,089	\$ 537	\$ 1,552

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In the third quarter of fiscal 2013, in conjunction with the interim goodwill impairment test discussed further below, management reviewed the intangible assets associated with the Ning Xiang subsidiary, which consisted primarily of customer relationships, for impairment. The Company recognized an impairment charge of \$851 thousand during the three months ended May 31, 2013 based on the present value of expected future net cash flows discounted at the weighted average cost of capital of Ning Xiang, taking into consideration a third-party independent valuation for the fair value of customer relationships. No impairment charge was recorded in fiscal 2012.

**Goodwill**

Due to a lower than expected revenue, profitability and cash flows reported by the Ning Xiang reporting unit for the nine months ended May 31, 2013, management determined that there were indicators of potential impairment, which required the Company to perform an interim impairment review of goodwill as of May 31, 2013. Based on the impairment test performed, management concluded that the carrying amount of the Ning Xiang reporting unit goodwill exceeded its implied fair value of zero and, as a result, a goodwill impairment loss of \$1,077 thousand was recognized during the three months ended May 31, 2013. The fair value of the Ning Xiang reporting unit was determined based on the present value of expected future net cash flows discounted at the weighted average cost of capital of Ning Xiang. The primary circumstance leading to the impairment of customer relationships, as discussed above, and goodwill was due to management's updated long-term financial forecasts, which reflected lower estimated near-term and longer-term revenues and profitability compared to estimates developed at the time of the acquisition in August 2011. No impairment charge was recorded in fiscal 2012.

**4. Investments in Unconsolidated Entities**

The Company's ownership interest and investments in unconsolidated entities as of May 31, 2013 and August 31, 2012 consisted of the following (in thousands, except percentages):

	May 31, 2013		August 31, 2012	
	Percentage Ownership	Amount	Percentage Ownership	Amount
Equity method investments:				
SILQ (Malaysia) Sdn. Bhd.	50%	\$ 371	50%	\$ 525
Xurui Guangdian Co., Ltd. ( China SemiLEDs )	49%		49%	
SS Optoelectronics Co., Ltd. ( SS Optoelectronics )			49%	248
Cost method investments	Various	1,986	Various	1,048
Total investments in unconsolidated entities		\$ 2,357		\$ 1,821

There were no dividends received from unconsolidated entities through May 31, 2013.

**Equity Method Investments**

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The carrying amount of the Company's investment in China SemiLEDs was reduced to zero as of August 31, 2012 as a result of the Company recognizing its proportionate share of the net loss reported by China SemiLEDs. The excess of the Company's share of the net assets of China SemiLEDs over the carrying amount of this investment was \$4.6 million as of August 31, 2012. The Company has suspended using the equity method of accounting and will no longer amortize the excess of the Company's share of the net assets of China SemiLEDs over the carrying amount of this investment until its share of future income, if any, from China SemiLEDs is sufficient to recover its share of the cumulative losses that have not previously been recognized.

In September 2012, SS Optoelectronics was dissolved in accordance with its joint venture agreement and the Company received return of investment of \$250 thousand.

The fair value of the Company's investments in the non-marketable stock of its equity method investees is not readily available. These investments, except for China SemiLEDs which had a zero carrying amount at May 31, 2013, are assessed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

Table of Contents**Cost Method Investments**

In October 2012, the Company acquired a 9.9% equity interest in High Power Optoelectronics, Inc. (HPO) for total cash consideration of \$2.9 million and has an option to increase its equity interest to more than 50% within one year of the acquisition. The fair values of the Company's cost method investments are not readily available. All cost method investments are assessed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable. In the third quarter of fiscal 2013, management reviewed the operating performance and financial condition of HPO based on the latest available financial statements of the investee and other publicly available information. Management considered the extent and duration of time to which the fair value of the investment has been less than its carrying amount, the financial condition of the investee and the prospect for recovery in the near term, and recognized an other-than-temporary impairment loss of \$1,885 thousand on its investment in HPO during the three months ended May 31, 2013.

**5. Indebtedness**

In January 2013, the Company entered into a NT dollar-denominated long-term credit facility providing for approximately \$4.1 million of borrowing capacity. The term of each draw down is three years and interest is calculated at a variable rate based on the annual time deposit rate plus an annual rate of 0.63%. The credit facility is secured by the Company's manufacturing equipment. As of May 31, 2013, the Company had drawn down \$2.9 million, which requires monthly payments of principal and interest in the amount of \$82 thousand with final payment to occur in April 2016. The interest rate on the outstanding balance under the facility was 2.0% per annum as of May 31, 2013.

**6. Commitments and Contingencies**

**Operating Lease Agreements** The Company has several operating leases with unrelated parties, primarily for land, plant and office spaces in Taiwan, which are noncancellable and which expire at various dates between August 2013 and December 2020. Lease expense related to these noncancellable operating leases was \$216 thousand and \$620 thousand for the three and nine months ended May 31, 2013, respectively, and \$208 thousand and \$604 thousand for the three and nine months ended May 31, 2012, respectively. Lease expense is recognized on a straight-line basis over the term of the lease. The aggregate future noncancellable minimum rental payments for the Company's operating leases as of May 31, 2013 consisted of the following (in thousands):

Years Ending August 31,	Operating Leases
Remainder of 2013	\$ 227
2014	872
2015	940
2016	884
2017	286
Thereafter	312
Total	\$ 3,521

**Purchase Obligations** The Company had purchase commitments for property, plant and equipment in the amount of \$3.7 million as of both May 31, 2013 and August 31, 2012.

**Litigation** From time to time, the Company is subject to legal proceedings and claims arising in the ordinary course of business. There were no material pending legal proceedings and claims as of May 31, 2013 and, to the best knowledge of management, there were none threatened as of May 31, 2013. During the three months ended May 31, 2012, the Company recognized an accrued liability for litigation settlement associated with the Cree litigation in the amount of \$1.5 million. The settlement payment was made in July 2012.

## 7. Stock-based Compensation

As of August 31, 2010, the Company had one stock-based compensation plan (the 2005 Plan ). In November 2010, SemiLEDs' board of directors and its stockholders approved the 2010 Equity Incentive Plan (the 2010 Plan ), which became effective upon the completion of the initial public offering on December 8, 2010.

In September 2012, SemiLEDs granted options for 100 thousand shares of SemiLEDs' common stock to an executive officer of the Company. The options vest over four years at a rate of 25% on each anniversary of the vesting start date and the options have a contractual term of ten years, subject to earlier expiration in the event of the holder's termination. The exercise price of stock options of \$1.72 was equal to the closing price of the common stock on the date of grant.

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In February 2013, SemiLEDs granted 211 thousand restricted stock units to its directors that vest 100% on the earlier of the first anniversary of the vesting start date of February 6, 2013 and the date of the next annual meeting. The grant-date fair value of the restricted stock units was \$0.71 per unit.

In April 2013, SemiLEDs granted 1,195 thousand restricted stock units to the Company's executives and employees. The restricted stock units vest over four years at a rate of 25% on each anniversary of the vesting start date of February 20, 2013, subject to earlier expiration in the event of the holder's termination. The grant-date fair value of the restricted stock units was \$1.33 per unit.

The grant date fair value of stock options is determined using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model requires inputs including the trading price of SemiLEDs' common stock on the date of grant, the term that the stock options are expected to be outstanding, the implied stock volatilities of several of the Company's publicly-traded peers over the expected term of stock options, risk-free interest rate and expected dividend. Each of these inputs is subjective and generally requires significant judgment to determine. The grant date fair value of stock units is based upon the market price of SemiLEDs' common stock on the date of the grant. This fair value is amortized to compensation expense over the vesting term.

Stock-based compensation expense is recorded net of estimated forfeitures such that expense is recorded only for those stock-based awards that are expected to vest. A forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. A forfeiture rate of zero is estimated for stock-based awards with vesting term that is less than or equal to one year from the date of grant.

A summary of the stock-based compensation expense for the three and nine months ended May 31, 2013 and 2012 was as follows (in thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2013	2012	2013	2012
Cost of revenues	\$ 211	\$ 182	\$ 653	\$ 774
Research and development	87	74	318	268
Selling, general and administrative	222	242	526	1,072
	\$ 520	\$ 498	\$ 1,497	\$ 2,114

### **8. Net Loss Per Share of Common Stock**

The following shares and stock-based compensation plan awards were excluded from the computation of diluted net loss per share of common stock for the periods presented because including them would have been anti-dilutive (in thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2013	2012	2013	2012
	787	128	580	535

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Stock units and stock options to purchase common stock		
Common stock subject to repurchase	1	1

### 9. Income Taxes

The Company's loss before income taxes for the three and nine months ended May 31, 2013 and 2012 consisted of the following (in thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2013	2012	2013	2012
U.S. operations	\$ (473)	\$ (2,562)	\$ (1,767)	\$ (6,679)
Foreign operations	(10,911)	(7,540)	(24,916)	(18,568)
Loss before income taxes	\$ (11,384)	\$ (10,102)	\$ (26,683)	\$ (25,247)

As of both May 31, 2013 and August 31, 2012, the Company had unrecognized tax benefits related to tax positions taken in prior periods of \$145 thousand, all of which would impact the Company's effective tax rate if recognized. The impact would be offset by an adjustment to the valuation allowance.



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Accrued interest and penalties related to unrecognized tax benefits were immaterial. The Company files income tax returns in the United States, various U.S. states and certain foreign jurisdictions. The tax years 2005 through 2012 remain open in most jurisdictions. The Company is not currently under examination by income tax authorities in U.S. federal and state or foreign jurisdictions.

**10. Related-Party Transactions**

The following material related-party transactions were reported in the Company's unaudited interim condensed consolidated statements of operations during the three and nine months ended May 31, 2013 and 2012 (in thousands):

Related Parties	Transactions	Three Months Ended May 31,		Nine Months Ended May 31,	
		2013	2012	2013	2012
China SemiLEDs	Sales of goods	\$	\$ 98	\$ 11	\$ 124
China SemiLEDs	Rendering of service		10		260
China SemiLEDs	Purchase of goods			301	
China SemiLEDs	Income recognized on patents assignment		12	38	38

Goods were bought and sold and services were provided in the ordinary course of business at prices and on terms negotiated on an arm's length basis. Income from the assignment of 13 patents to China SemiLEDs pursuant to a patent assignment and license agreement entered into in March 2011 was initially deferred and is being amortized in other income over the life of the assigned patents.

As of May 31, 2013 and August 31, 2012, the Company had accounts receivable from China SemiLEDs arising from the sales of goods and provision of services, as described above, the payment of expenses on behalf of China SemiLEDs, and the sale of equipment during fiscal 2012 in the amount of \$244 thousand, and notes receivable from short-term lines of credit extended to China SemiLEDs during fiscal 2012 in an aggregate amount of approximately \$0.2 million, which China SemiLEDs had defaulted upon. Management evaluated the Company's ability to collect on these accounts and notes receivable from China SemiLEDs and recorded a charge to bad debt expense of \$1,405 thousand at August 31, 2012. Amounts due from and to China SemiLEDs as of May 31, 2013 and August 31, 2012 were reported in the Company's consolidated balance sheets as follows (in thousands):

	May 31, 2013	August 31, 2012
Accounts and notes receivable from related parties, net of allowance for doubtful accounts of \$1,388 and \$1,405 as of May 31, 2013 and August 31, 2012, respectively	\$ 7	\$ 118
Other current liabilities	\$	\$ 65

In April 2013, a majority owned subsidiary entered into a one-year unsecured NT dollar-denominated loan in the amount of \$0.2 million with one of its shareholders to fulfill short-term financing needs. Total outstanding balance was \$0.2 million as of May 31, 2013. The loan bears a fixed interest rate of 3.0% per annum. Management believes that the terms of this transaction are at current market rates and would not have been any different had it been negotiated with an independent third party.



Table of Contents**11. Fair Value Measurements**

The following table presents assets that were measured at fair value on a nonrecurring basis as of May 31, 2013 (in thousands):

	Fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total losses
Customer relationships	\$	\$	\$	\$	\$ 851
Goodwill					1,077
Investment in non-marketable equity security HPO	938			938	1,885
Total	\$ 938	\$	\$	\$ 938	\$ 3,813

The intangible asset for customer relationships arising from the acquisition of a 51% equity interest in Ning Xiang with a carrying amount of \$0.8 million was written down to its fair value of zero, resulting in an impairment charge of \$851 thousand during the three months ended May 31, 2013. Management determined the fair value of customer relationships using the multi-period excess earnings method under the income approach. Under this approach, the fair value of customer relationships acquired was determined based on the present value of estimated future net cash flows expected to be generated from the Ning Xiang asset group adjusted for a contributory asset charge, which represented the cash flows of the other assets that contributed to the overall cash flows. Significant estimates and assumptions included sales, estimated growth rate, profitability, discount rate, customer attribution rate and contributory asset charge, among others.

Goodwill with a carrying amount of \$1.1 million was written down to its implied fair value of zero, resulting in an impairment charge of \$1,077 thousand during the three months ended May 31, 2013. The fair value of the Ning Xiang reporting unit was determined based on the present value of estimated future net cash flows discounted at the weighted average cost of capital. Management estimated future net cash flows using the reporting unit's internally developed estimates and included a terminal value calculated using a long-term future growth rate based on analysis of current and expected future economic conditions. Significant estimates and assumptions included sales, estimated growth rate, profitability and discount rate, among others.

An impairment loss on the Company's investment in HPO was recognized based on the excess of the carrying amount over the estimated fair value. The fair value of the investment was determined based on management's best estimate of the amount that could be realized from the investment, which considered the latest net asset value reported by the investee and events that have occurred after the investee's balance sheet date. Management believes the estimated fair value reflected the exit price from a market participant's perspective at May 31, 2013.

The following table presents assets that were measured at fair value on a nonrecurring basis as of August 31, 2012 (in thousands):

Fair value	Quoted prices in	Significant other	Significant unobservable	Total losses
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			active markets for identical assets (Level 1)		observable inputs (Level 2)		inputs (Level 3)		
Property, plant and equipment	\$	46,450	\$		\$		\$	46,450	\$ 7,507

Property, plant and equipment with a carrying amount of \$54.0 million was written down to its fair value of \$46.5 million, resulting in an impairment charge of \$7.5 million, which was included in the consolidated statement of operations for the year ended August 31, 2012.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward Looking Statements**

This Quarterly Report on Form 10-Q, or this Quarterly Report, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical facts contained in this Quarterly Report, including statements regarding the future results of operations of SemiLEDs Corporation, or we, our or the Company, and financial position, strategy and plans, our expectations for future operations, and our ability or inability to maintain compliance in the future with NASDAQ continued listing standards, are forward-looking statements. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. The words believe, may, should, plan, potential, project, will, estimate, anticipate, design, intend, expect and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, and actual results and the timing of certain events could differ materially and adversely from those anticipated or implied in the forward-looking statements as a result of many factors. These factors include, among other things,

- Our ability to reduce our net losses and to restore our operations to profitability.
  
- Our ability to successfully manage our operations in the face of the cyclical, rapid technological change, rapid product obsolescence, declining average selling prices and wide fluctuations in supply and demand typically found in the LED market.
  
- Competitive pressures from existing and new companies.
  
- Our ability to grow our revenues generated from the sales of our products and to control our expenses.
  
- Our ability to successfully introduce new products that we can produce and that customers will purchase in such amounts as to be sufficiently profitable to cover the costs of developing and producing these products, as well as providing us additional net income from operations.
  
- Our ability to improve our gross margins.
  
- Loss of any of our key personnel, or our failure to attract, assimilate and retain other highly qualified personnel.

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- Intellectual property infringement or misappropriation claims by third parties against us or our customers, including our distributor customers.
- The failure of LEDs to achieve widespread adoption in the general lighting market, or if alternative technologies gain market acceptance.
- The loss of key suppliers or contract manufacturers.
- The inability of contract manufacturers to produce products that satisfy our requirements.
- Our ability to effectively expand or upgrade our production facilities or do so in a timely or cost-effective manner.
- Difficulty in managing our future growth or in responding to a need to contract operations, and the associated changes to our operations.
- Adverse development in those selected markets, including China, Taiwan, Russia and the United States, where our revenues are concentrated.
- Our ability to develop and execute upon a new strategy to exploit the China market.
- The reduction or elimination of government investment in LED lighting or the elimination of, or changes in, policies in certain countries that encourage the use of LEDs over some traditional lighting technologies.

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- Our ability to cost-effectively produce LED chips using larger wafer sizes.
  
- Our ability to implement our product innovation strategy effectively, particularly in view of the prohibition against our (and/or our assisting others in) making, using, importing, selling and/or offering to sell in the United States our accused products and/or any device that includes an accused product after October 1, 2012 as a result of the injunction agreed to in connection with the Cree Inc., or Cree, litigation.
  
- Loss of customers.
  
- Failure of our strategy of marketing and selling our products in jurisdictions with limited intellectual property enforcement regimes.
  
- Lack of marketing and distribution success by our third-party distributors.
  
- Our customers' ability to produce and sell products incorporating our LED products.
  
- Our failure to adequately prevent disclosure of trade secrets and other proprietary information.
  
- Ineffectiveness of our disclosure controls and procedures and our internal control over financial reporting.
  
- Our ability to profit from existing and future joint ventures, investments, acquisitions and other strategic alliances.
  
- Impairment of goodwill, long-lived assets or investments;
  
- Undetected defects in our products that harm our sales and reputation and adversely affect our manufacturing yields.
  
- The availability of adequate and timely supply of electricity and water for our manufacturing facilities.

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- Our ability to comply with existing and future environmental laws and the cost of such compliance.
- The non-compete provisions between us and Xurui Guangdian Co., Ltd., or China SemiLEDs, constraining our ability to grow in China, or actions by China SemiLEDs or the other shareholders of China SemiLEDs that are detrimental to us.
- The ability of SemiLEDs Optoelectronics Co., Ltd., or Taiwan SemiLEDs, to make dividends and other payments to us.
- Our ability to obtain necessary regulatory approvals to make further investments in Taiwan SemiLEDs.
- Catastrophic events such as fires, earthquakes, floods, tornados, tsunamis, typhoons, pandemics, wars, terrorist activities and other similar events, particularly if these events occur at or near our operations, or the operations of our suppliers, contract manufacturers and customers.
- The effect of the legal system in the People's Republic of China, or the PRC.
- Labor shortages, strikes and other disturbances that affect our operations.
- Deterioration in the relations between the PRC and Taiwan governments.
- Fluctuations in the exchange rate between the U.S. dollar, the New Taiwan, or NT, dollar and other currencies in which our sales, raw materials and component purchases and capital expenditures are denominated.
- Our ability to obtain additional equity capital or credit when necessary for our operations, the difficulty of which may increase if our common stock is delisted from The NASDAQ Stock Market.
- The effect of new disclosure requirements under the new provisions of the Dodd-Frank Act relating to conflict minerals, which could increase our costs and limit the supply of certain metals used in our products and affect our reputation with customers and shareholders.
- The impact on the trading price of our common stock if we are delisted for failure to meet the NASDAQ continued listing requirements if our stock trades below \$1 per share.





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Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We have not assumed any obligation to, and you should not expect us to, update or revise these statements because of new information, future events or otherwise.

For more information on the significant risks that could affect the outcome of these forward-looking statements, see Item 1A Risk Factors in Part I of our Annual Report on Form 10-K for the fiscal year ended August 31, 2012, or the 2012 Annual Report, and those contained in Part II, Item 1A of this Quarterly Report, and other information provided from time to time in our filings with the Securities and Exchange Commission, or the SEC.

The following discussion and analysis of our financial condition and results of operations is based upon and should be read in conjunction with the unaudited interim condensed consolidated financial statements and the notes and other information included elsewhere in this Quarterly Report, in our 2012 Annual Report, and in other filings with the SEC.

**Company Overview**

We develop, manufacture and sell LED chips and LED components that we believe are among the industry-leading LED products on a lumens per watt basis. Our products are used primarily for general lighting applications, including street lights and commercial, industrial and residential lighting. Our LED chips may also be used in specialty industrial applications, such as ultraviolet, or UV, curing of polymers, LED light therapy in medical/cosmetic applications, counterfeit detection, and LED lighting for horticulture applications. Our core products are LED chips and LED components, but lighting products have also become an increasingly important part of our business.

Utilizing our patented and proprietary technology, our manufacturing process begins by growing upon the surface of a sapphire wafer, or substrate, several very thin separate semiconductive crystalline layers of gallium nitride, or GaN, a process known as epitaxial growth, on top of which a mirror-like reflective silver layer is then deposited. After the subsequent addition of a copper alloy layer and finally the removal of the sapphire substrate, we further process this multiple-layered material to create individual LED chips.

We sell blue, green and UV LED chips under our MvpLED brand to a customer base that is heavily concentrated in a few select markets, including China, Taiwan, Russia and the United States. During the fourth quarter of our fiscal 2012, we launched our new Enhanced Vertical, or EV, LED product series in blue, green and UV, as well as a new ceramic LED component that incorporates the EV chip. We sell our LED chips to packagers or to distributors, who in turn sell to packagers. In addition, we package a portion of our LED chips into LED components, which we sell to distributors and end-customers in selected markets. We also contract other manufacturers to produce for our sale certain LED components products based on our design and technology requirements and under our quality control specifications and final inspection process. Our lighting products customers are primarily original design manufacturers of lighting products and the end-users of lighting devices.

We have developed advanced capabilities and proprietary know-how in:

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- reusing sapphire substrate in subsequent production runs;
- optimizing our epitaxial growth processes to create layers that efficiently convert electrical current into light;
- employing a copper alloy base manufacturing technology to improve our chip s thermal and electrical performance;
- utilizing nanoscale surface engineering to improve usable light extraction; and
- developing a LED structure that generally consists of multiple epitaxial layers which are vertically-stacked on top of and a copper alloy base.

These technical capabilities enable us to produce LED chips that can provide efficacies of greater than 100 lumens per watt when packaged. We believe these capabilities and know-how also allow us to reduce our manufacturing costs and our dependence on sapphire, a costly raw material used in the production of sapphire-based LED devices. In addition, we believe our technological know-how and capabilities will help facilitate our migration to larger wafer sizes.

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We were incorporated in Delaware in January 2005 and sold our first LED chips in November 2005. We are a holding company for various wholly and majority owned subsidiaries and joint ventures. Our most significant subsidiary is our wholly owned operating subsidiary, Taiwan SemiLEDs, where a substantial portion of our assets are held and located, where a substantial portion of our research, development, manufacturing, marketing and sales activities take place, and where most of our employees are based. As of May 31, 2013, we also owned a 66% interest in Ning Xiang Technology Co., Ltd., or Ning Xiang, which consists of a 51% interest that we acquired in August 2011 and an additional 15% interest that we acquired in April 2013. The acquisition of additional interest in Ning Xiang was accounted for as an equity transaction. Ning Xiang is engaged in the design, manufacture and sales of lighting fixtures and systems. In addition, as of May 31, 2013, we owned a 50% interest in SILQ (Malaysia) Sdn. Bhd., or SILQ, a joint venture established in Malaysia to design, manufacture and sell lighting fixtures and systems. We account for our investment in SILQ using the equity method of accounting.

As of May 31, 2013, we owned a 49% equity interest in China SemiLEDs, an equity method investee that had originally been significant to our China strategy, but that we wrote down the investment to a carrying value of zero at August 31, 2012. See discussion further below.

In October 2012, the Company acquired a 9.9% equity interest in High Power Optoelectronics, Inc. ( HPO ) for total cash consideration of \$2.9 million and has an option to increase its equity interest to more than 50% within one year of the acquisition. We have also become the exclusive distributor for HPO's LED products having a wavelength that is 560 microns or shorter and a distributor for those that are longer. In addition, we have entered into a joint research and development agreement with HPO to develop LED products. The acquisition was for strategic reasons, including, among other things, to focus on the Taiwan market, to expand our product portfolio and diversify our sales and to develop complementary technologies and products. In the third quarter of our fiscal 2013, we recognized an other-than-temporary impairment loss of \$1.9 million on our investment in HPO. See discussion further below.

**Key Factors Affecting Our Financial Condition, Results of Operations and Business**

The following are key factors that we believe affect our financial condition, results of operations and business:

- **General economic conditions and geographic concentration.** The global financial crisis that began in late 2007 caused extreme disruption in the financial markets. Although the disruption in the global financial markets moderated thereafter, concerns remain that problems affecting the economies and budgets of European Union members, continued slow economic activity in China and some other developing markets and the inability of the United States to sustain a more robust economic recovery, may precipitate wider global contraction that could have a significant impact on the LED industry and our financial results. When the global economy slows or a financial crisis occurs, consumer and government confidence declines, with levels of government grants and subsidies for LED adoption and consumer spending likely to be adversely impacted. Our revenues have been concentrated in a few select markets, including China, Taiwan, Russia and the United States. Given that we are an early-stage company operating in a rapidly changing industry, our sales in specific markets may fluctuate from quarter to quarter. Therefore, our financial results will be impacted by general economic and political conditions in such markets. In addition, we derive a significant portion of our revenues from a limited number of customers. Some of our largest customers and what we produce/have produced for them have changed from quarter to quarter primarily as a result of the timing of discrete, large project-based purchases and broadening customer base, among other things. For the three and nine months ended May 31, 2013, sales to our three largest customers, in the aggregate, accounted for 18% and 16% of our revenues, respectively.

- **Industry growth and demand for products and applications using LED chips.** The overall adoption of LED lighting devices to replace traditional lighting sources is expected to influence the growth and demand for LED chips and impact our financial performance. Since a substantial portion of our LED chips and LED components and our lighting products is used by end-users in general lighting applications, the adoption of LEDs into these applications will have a strong impact on the demand of LED chips generally and, as a result, for our LED chips, LED components and LED lighting products. Fluctuations in demand of LED lights products will also affect the results of Ning Xiang.
  
- **Average selling price of our products.** Our financial performance is affected by the average selling price of our LED chips and LED components. The price that we charge to our customers is subject to a variety of factors, including prices charged by our competitors, the efficacy of our products, our cost basis, the size of the order and our relationship with the relevant customer, as well as general market and economic conditions. Competition in the markets for LED products is intense, and we expect that competition will continue to increase. Increased competition, which began in calendar year 2011, and continued through the third quarter of our fiscal 2013, created a highly aggressive pricing environment. Some of our competitors have in the past reduced their average selling prices, and the resulting competitive pricing pressures have caused us to similarly reduce our prices, accelerating the decline in the gross margin of our products. When prices decline, we must also write down the value of our inventory. Average selling prices are also affected by the mix of products that we sell in any given period. In particular, as the LED industry develops and technical specifications and market standards change, we must continue to develop and offer competitive products that meet our customers' specifications and pricing requirements. Average selling prices for our LED chips and LED components are also impacted to a significant extent by the stage of our products' life cycles, with average selling prices being higher early in the life cycle of a product and prices decreasing over time as products age and new products with higher efficacies are introduced. Therefore, our ability to continue to innovate by introducing higher efficacy LED chips at lower costs will have a material influence on our ability to improve our product margins, although in the near term the introduction of such higher efficacy LED chips may further reduce the selling prices of our existing products or render them obsolete. Reduction in the average selling price of LED lighting products will also affect the results of Ning Xiang.

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- ***Changes in our product mix.*** We anticipate that our gross margins will fluctuate from period to period as a result of the mix of products that we sell and the utilization of our manufacturing capacity in any given period, among other things. For example, in fiscal 2012, we placed greater emphasis on the sales of LED components rather than the sales of LED chip where we have been forced to cut prices on older inventory. In particular, we sold a significant volume of a category of lower-priced LED components designed to meet our customers' demand. While such a shift in product mix to lower-priced products had lowered our average selling price, the significant sales volume had helped to improve revenues and gross margin in fiscal 2012. We intend to continue to pursue opportunities for profitable growth in areas of business where we see the best opportunity for our new EV LED product series of LED chips (particularly the UV market) and continue to expand the lower-priced LED components as appropriate. However, as we expand and diversify our product offering and with varying average selling prices, a change in the mix of products that we sell in any given period may increase volatility in our revenues and gross margin from period to period.
- ***Our ability to reduce cost to offset lower average prices.*** Competitors may reduce average selling prices faster than our ability to reduce costs, and competitive pricing pressures may accelerate the rate of decline of our average selling prices. To address increased pricing pressure, we have invested in the development of larger wafer sizes, in particular using 4" wafers, which we believe should lower our production costs. We have substantially converted our manufacturing of LED chips based on 4" wafer technology. We have also improved and increased our production yields to reduce the per-unit cost of production for our products. However, such cost savings currently have limited impact on our gross profit, as we suffered from the underutilization of our manufacturing capacity, primarily for our LED chips, starting in the fourth quarter of our fiscal 2011, and continuing through the third quarter of our fiscal 2013, and must absorb a high level of fixed cost such as depreciation. While we intend to focus on managing our costs and expenses, over the long term we expect to be required to invest substantially if we are to grow.
- ***Intellectual property issues.*** Competitors of ours and other third parties have in the past and will likely from time to time in the future allege that our products infringe on their intellectual property rights. Defending against any intellectual property infringement claims would likely result in costly litigation and ultimately may lead to our not being able to manufacture, use or sell products found to be infringing. We have settled the intellectual property dispute involving Cree. We agreed to the entry of a permanent injunction that was effective October 1, 2012 that precludes us from (and/or from assisting others in) making, using, importing, selling and/or offering to sell in the United States certain accused products and/or any device that includes such an accused product after that date and to payment of a settlement fee for past damages. Revenue from sales in the United States of LED chips and LED components subject to the injunction accounted for 7% of our revenue for the year ended August 31, 2012. All remaining claims between Cree and us were withdrawn without prejudice, with each retaining the right to assert them in the future. However, other third parties may also assert infringement claims against our customers with respect to our products, or our customers' products that incorporate our technologies or products. Any such legal action or the threat of legal action against us, or our customers, could impair such customers' continued demand for our products. This could prevent us from growing or even maintaining our revenues, or cause us to incur additional costs and expenses, and adversely affect our financial condition and results of operations.
- ***Our ability to continue to innovate.*** As part of our growth strategy, we plan to continue to be innovative in product design, to deliver new products and to improve our manufacturing efficiencies. Our continued success depends on our ability to develop and introduce new, technologically advanced and lower cost products, such as more efficient, higher brightness LED chips. If we are unable to introduce new products that are commercially viable and meet rapidly evolving customer requirements or keep pace with evolving technological standards and market developments or are otherwise unable to execute our product innovation strategy effectively, we may not be able to take advantage of market opportunities as they arise, execute our business plan or be able to compete effectively. During the fourth quarter of our fiscal 2012, we launched our new EV LED product series, capable of operating at a higher junction temperature and with higher thermal endurance, as well as a new ceramic LED component that incorporates the EV chip and also offers customers greater flexibility in making color choices. Our near-term success will depend upon how attractive these products are to our customers versus competitors' offerings and our customers' willingness and promptness in qualifying the EV LED products.



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- ***Our ability to achieve consistently high manufacturing yields.*** We measure our manufacturing yield per wafer by the number of saleable LED chips produced, compared to the theoretical maximum number of LED chips that can be produced on such wafer. It is critical for us to achieve high manufacturing yields in order to improve our margins. We expect to have to continually attain higher yields from our existing wafer sizes and develop new technologies that allow us to efficiently migrate to larger wafer sizes. Our success in achieving sufficient profitability with respect to the recently launched EV LEDs also requires that we optimize our manufacturing process to achieve suitable yields as soon as possible.
  
- ***Our ability to realize our strategic initiatives.*** Our China strategy was initially premised on continuing our growth in China through China SemiLEDs. The launch of China SemiLEDs was not successful, coinciding with a downturn in the number of LED street and tunnel light projects financed by the Chinese government, which was its target market. Although it tried to shift its focus, China SemiLEDs faced intense competition and its shareholders decided to suspend operations temporarily until all shareholders agreed to a new operating plan. The shareholders of China SemiLEDs have been working towards implementing a restructuring of China SemiLEDs and entered into a restructuring agreement in February 2013. The restructuring is subject to the approval of the Department of Foreign Trade and Economic Cooperation of Guangdong Province. Under the agreed restructuring plan, China SemiLEDs' second largest shareholder would contribute an additional RMB50.0 million (approximately \$8.0 million) to China SemiLEDs and increase its ownership interest to approximately 60.5%, the effect of which would be to dilute the ownership interests of all other shareholders, including ours. Under the new capital structure, our ownership interest would be approximately 16.3%. The new majority owner would also assume control of China SemiLEDs' operations. Even with the infusion of this new capital, it is uncertain whether China SemiLEDs will be successful. We may not be able to recover anything from our investment. Furthermore, we now no longer view China SemiLEDs as the vehicle to drive our growth in China. As the world's second largest economy and one that is geographically close to our manufacturing operations, China continues to represent a key market for our products and we will now be executing our China strategy through our wholly owned subsidiary based in Shenzhen, China, to exploit the opportunities that it presents and to serve our customers in China.

**Critical Accounting Policies and Estimates**

Except for the following, there have been no material changes in the matters for which we make critical accounting policies and estimates in the preparation of our unaudited interim condensed consolidated financial statements for the nine months ended May 31, 2013 as compared to those disclosed in our 2012 Annual Report.

***Impairment of Long-lived Assets***

For property, plant and equipment, we first determine whether indicators of impairment are present. Circumstances such as the discontinuation of a product or product line, a sudden or consistent decline in the forecast for a product, changes in technology or in the way an asset is being used, a history of negative operating cash flow, or an adverse change in legal factors or in the business climate, among others, may trigger an impairment review. Second, if we determine that indicators of impairment are present, we determine whether the estimated undiscounted cash flows expected to be generated from the use and eventual disposal of the potentially impaired assets are less than the carrying amount. Third, if such estimated undiscounted cash flows do not exceed the carrying amount, we estimate the fair value of the asset and record an impairment charge if the carrying amount is greater than the fair value of the asset. Fair value is determined through various valuation techniques, including discounted cash flow models, quoted market values and third-party independent appraisers, as considered necessary. We group our long-lived assets with other assets and liabilities at the lowest level for which identifiable cash flows are generated, or an asset group. We determined that we have two asset groups for impairment testing purposes, one of which is associated with the manufacture and sale of LED chips and LED components, and another one is associated with our Ning Xiang subsidiary, which is engaged in the manufacture and sale of lighting fixtures and



systems.

In the third quarter of fiscal 2013, in conjunction with the interim goodwill impairment test discussed below, we reviewed our long-lived assets associated with our Ning Xiang subsidiary, which consisted primarily of customer relationships intangible asset for impairment. Based on our assessment, the total estimated undiscounted future net cash flows expected to be received from this asset group were less than its carrying amount as of May 31, 2013. Therefore, we determined that impairment was indicated and the carrying amount of our long-lived assets might not be fully recoverable. We then determined the fair value of the asset group using the present value of expected future net cash flows using Level 3 inputs discounted at the weighted average cost of capital of Ning Xiang, taking into consideration a third-party independent valuation. As a result, we recognized a \$0.9 million impairment write-down on our long-lived assets associated with our Ning Xiang subsidiary during the three months ended May 31, 2013, which was reflected as a separate line item in our unaudited interim condensed consolidated statement of operations. The impairment charge was allocated to the customer relationships intangible asset, which was written down to its fair value of zero. The impairment was primarily driven by our updated long-term financial forecasts, which reflected a lower estimated near-term and longer-term revenues and profitability compared to estimates we developed at the time of the acquisition in August 2011. Significant estimates and assumptions include sales, estimated growth rates, profitability, discount rate, customer attribution rate and contributory asset charge, among others. The updated estimates of future cash flows represent our best estimate at this time based on reasonable and supportable assumptions. The use of different assumptions could increase or decrease the estimates of expected future cash flows and therefore, impact the related impairment charge.

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In the third quarter of fiscal 2013, we did not identify any triggering event that required us to perform an interim impairment review for our long-lived assets that associated with the manufacture and sale of LED chips and LED components.

For the year ended August 31, 2012, we recognized a \$7.5 million impairment write-down on certain of our property, plant and equipment used in the manufacturing of LED chips. We did not recognize any impairment charges on our long-lived assets during the year ended August 31, 2011.

*Impairment of Goodwill*

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. We recognized goodwill in the amount of \$1.1 million for the acquisition of a 51% equity interest in Ning Xiang in August 2011. All of the goodwill was assigned to the Ning Xiang reporting unit. In determining whether goodwill is impaired and measuring any loss resulting from an impairment. We first determine whether the fair value of the reporting unit is less than its carrying amount (including goodwill). The fair value of the reporting unit is determined using a discounted cash flows analysis. Second, if the fair value of the reporting unit does not exceed the carrying amount, we record an impairment loss for the excess of the carrying amount of the reporting unit goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. We perform impairment test on goodwill annually on the first business day of August, or more frequently when a triggering event occurs between annual impairment tests.

Due to a lower than expected revenue, profitability and cash flows reported by the Ning Xiang reporting unit for the nine months ended May 31, 2013, we determined that there were indicators of potential impairment, which required us to perform an interim impairment test on the Ning Xiang reporting unit goodwill as of May 31, 2013. We determined the fair value of the Ning Xiang reporting unit based on the present value of estimated future net cash flows using Level 3 inputs discounted at the weighted average cost of capital of Ning Xiang. We developed our expected future net cash flows based on historical data and internally developed estimates as part of our long-term planning process, which considered current and expected economic conditions and the updated strategic plan for the Ning Xiang reporting unit, and included a terminal value calculated using a long-term future growth rate, taking into consideration the assumptions that we believed a market participant would use in measuring fair value. Based on the impairment test performed, we concluded that the carrying amount of the Ning Xiang reporting unit goodwill exceeds its implied fair value of zero and, as a result, we recognized a goodwill impairment loss of \$1.1 million during the three months ended May 31, 2013, which was reflected as a separate line item in our unaudited interim condensed consolidated statement of operations. The decline in the implied fair value of the Ning Xiang reporting unit goodwill and the resulting impairment loss was primarily driven by our updated long-term financial forecasts, which reflected a lower estimated near-term and longer-term revenues and profitability compared to estimates we developed at the time of the acquisition in August 2011. Significant estimates and assumptions include sales, estimated growth rates, profitability and discount rate, among others. The updated estimates of future cash flows involve subjective judgments and represent our best estimate about future developments, determined based on reasonable and supportable assumptions and projections taking into account past experience, as well as market data obtained from independent external sources. The use of different estimates, assumptions and judgments could result in a significantly different estimate of the fair value for the Ning Xiang reporting unit.

We did not recognize any impairment charges on goodwill during the years ended August 31, 2012 and 2011.

*Recovery of Investments in Unconsolidated Entities*

We evaluate the recoverability of the carrying amount of our equity investments accounted for using the equity method and cost method when there is an indication of potential impairment. When an indication of potential impairment is present, we record a write-down of the equity investment if and when the amount of its estimated realizable value falls below carrying amount and we determine that this shortfall is other-than-temporary. Indications of a potential impairment that would cause us to perform this evaluation include, but are not necessarily limited to, an inability of the investee to sustain an earnings capacity that would justify the carrying amount of the investment or a quoted market price per share that remains significantly below our carrying amount per share for a sustained period of time. In determining whether a decline in the investment's estimated realizable value is other-than-temporary, we consider the length of time and the extent to which such value has been less than the carrying amount, the financial condition and prospects of the investee, and our ability and intent to retain our equity investment for a period of time sufficient to allow for any

anticipated recovery in value. In the event that we determine that a decline in value is other-than-temporary, we recognize an impairment charge for the reduction in the value of the equity investment.

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In the third quarter of fiscal 2013, we reviewed the operating performance and financial condition of HPO based on the latest available financial statements of the investee and other publicly available information. We considered the extent and duration of time to which the fair value of the investment has been less than the carrying amount, the financial condition of the investee and prospect for recovery in the near term, and recognized an other-than-temporary impairment loss of \$1.9 million on our investment in HPO during the three months ended May 31, 2013. The fair value of the investment was determined based on our best estimate of the amount that could be realized from the investment, which considered the latest net asset value reported by the investee and events that have occurred after the investee's balance sheet date. We believe the estimated fair value reflected the exit price from a market participant's perspective as of May 31, 2013.

We did not recognize any impairment charges due to other-than-temporary declines in the value of our equity investments during the years ended August 31, 2012 and 2011.

**Exchange Rate Information**

We are a Delaware corporation and, under SEC requirements, must report our financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. At the same time, our subsidiaries use the local currency as their functional currency. For example, the functional currency for Taiwan SemiLEDs is the NT dollar. The assets and liabilities of the subsidiaries are, therefore, translated into U.S. dollars at exchange rates in effect at each balance sheet date, and income and expense accounts are translated at average exchange rates during the period. The resulting translation adjustments are recorded to a separate component of accumulated other comprehensive income (loss) within equity. Any gains and losses from transactions denominated in currencies other than their functional currencies are recognized in the consolidated statements of operations as a separate component of other income (expense). Due to exchange rate fluctuations, such translated amounts may vary from quarter to quarter even in circumstances where such amounts have not materially changed when denominated in their functional currencies.

The translations from NT dollars to U.S. dollars for periods prior to January 1, 2011 were made at the exchange rates published on OANDA.com. For January 1, 2011 and all later dates and periods, the exchange rate refers to the exchange rate as set forth in the statistical release of the Bank of Taiwan. On August 31, 2012, the exchange rate was 29.93 NT dollars to one U.S. dollar. On May 31, 2013, the exchange rate was 29.93 NT dollars to one U.S. dollar. On July 5, 2013, the exchange rate was 30.04 NT dollars to one U.S. dollar.

The following table sets forth, for the periods indicated, information concerning the number of NT dollars for which one U.S. dollar could be exchanged.

	Average(1)	NT dollars per U.S. dollar		Period-End
		High	Low	
Fiscal 2011	29.53	32.04	31.26	29.01
Fiscal 2012	29.86	30.68	28.95	29.93
September 2012	29.53	29.89	29.29	29.30
October 2012	29.26	29.32	29.19	29.22
November 2012	29.13	29.25	29.00	29.06
December 2012	29.06	29.09	29.04	29.04
January 2013	29.09	29.55	28.95	29.54
February 2013	29.61	29.73	29.51	29.66

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March 2013	29.74	29.90	29.62	29.83
April 2013	29.91	30.02	29.86	30.02
May 2013	29.78	29.97	29.40	29.93
June 2012	29.95	30.20	29.74	30.00
July 2013 (through July 5, 2013)	30.03	30.07	30.00	30.04

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(1) Annual averages calculated from month-end rates and monthly averages calculated from daily closing rates.

No representation is made that the NT dollar or U.S. dollar amounts referred to herein could have been or could be converted into U.S. dollars or NT dollars, as the case may be, at any particular rate or at all.

Table of Contents**Results of Operations****Three Months Ended May 31, 2013 Compared to the Three Months Ended May 31, 2012**

	Three Months Ended May 31,		2012		Change \$	Change %
	2013	% of Revenues	\$	% of Revenues		
	\$		\$			
			(in thousands)			
LED chips	\$ 990	28%	\$ 2,303	25%	\$ (1,313)	(57)%
LED components	1,517	43%	4,661	51%	(3,144)	(67)%
Lighting products	873	25%	1,377	15%	(504)	(37)%
Other revenues	146	4%	837	9%	(691)	(83)%
Total revenues, net	3,526	100%	9,178	100%	(5,652)	(62)%
Cost of revenues	8,083	229%	10,232	111%	(2,149)	(21)%
Gross loss	\$ (4,557)	(129)%	\$ (1,054)	(11)%	\$ (3,503)	332%

**Revenues, net**

Our revenues decreased by approximately 62% from \$9.2 million for the three months ended May 31, 2012 to \$3.5 million for the three months ended May 31, 2013. The \$5.7 million decrease in revenues reflects a \$3.1 million decrease in revenues attributable to sales of LED components, a \$1.3 million decrease in revenues attributable to sales of LED chips, a \$0.7 million decrease in other revenues and a \$0.5 million decrease in revenues attributable to the sales of lighting products.

Revenues attributable to the sales of our LED chips represented 28% and 25% of our revenues for the three months ended May 31, 2013 and 2012, respectively. During the three months ended May 31, 2013, the average selling price of our LED chips was 76% lower as compared to the three months ended May 31, 2012, but volume of LED chips sold was 85% higher, primarily due to our decision to phase out and clear a significant volume of older inventory in our LED chips portfolio at discounted prices in a one-time sale. Our introduction of new EV LED chips had rendered such older inventory obsolete. The decrease in the average selling price of LED chips reflected our sales of such older inventory, and also as a result of continued market downward pricing pressure. The decrease in revenues attributable to sales of LED chips was also due to our attempt to direct efforts to areas of business where we see the best opportunity for the most profitable sales of our LED chips. This strategy, however, did not have a positive impact on our revenues during the three months ended May 31, 2013, primarily because we were unable to develop and expand our customer base and distribution channels in a timely manner, and because we did not obtain qualifications from certain of our existing customers and potential customers on our new EV LED chips and new business initiatives.

Revenues attributable to the sales of our LED components represented 43% and 51% of our revenues for the three months ended May 31, 2013 and 2012, respectively. The decrease in revenues attributable to sales of LED components was primarily driven by reduced sales of a category of lower-priced LED components that we had previously sold in significant volume to distributor customers during the three months ended May 31, 2012. During the three months ended May 31, 2013, the volume of LED components sold was 85% lower, but average selling price of LED components was 112% higher as compared to the three months ended May 31, 2012, primarily due to a slowdown in customer demand for the lower-priced LED components. The increase in the average selling price of LED components reflected a shift in our product mix to a

reduced proportion of such lower-priced LED components.

Revenues attributable to the sales of lighting products represented 25% and 15% of our revenues for the three months ended May 31, 2013 and 2012, respectively. The decrease in revenues attributable to the sales of lighting products was primarily due to reduced sales reported by Ning Xiang, primarily as a result of decreased demand from certain of its large customers.

The decrease in other revenues was primarily due to lower sales of scraps.

***Cost of Revenues***

Our cost of revenues decreased by 21% from \$10.2 million for the three months ended May 31, 2012 to \$8.1 million for the three months ended May 31, 2013. The decrease in cost of revenues was primarily due to lower sales during the three months ended May 31, 2013. The decreases, however, were offset in part by increases in excess capacity charges and inventory valuation adjustments, primarily for our LED chips, and increases in cost of revenues driven primarily by the volume of LED chips sold as a result of inventory clearance. Factory utilization was lower during the three months ended May 31, 2013, primarily due to lower sales and our decision to work down our inventory levels for our LED chips. Inventory write-downs increased from \$0.7 million for the three months ended May 31, 2012 to \$1.1 million for the three months ended May 31, 2013.

Table of Contents**Gross Loss**

Our gross loss increased from a loss of \$1.1 million for the three months ended May 31, 2012 to a loss of \$4.6 million for the three months ended May 31, 2013. Our gross margin percentage was negative 129% for the three months ended May 31, 2013, as compared to negative 11% for the three months ended May 31, 2012, as a consequence of the significant reduction in revenues, excess capacity charges and inventory valuation adjustments for our LED chips, as more fully described above.

**Operating Expenses**

	2013		Three Months Ended May 31, 2012		Change \$	Change %
	\$	% of Revenues	\$	% of Revenues		
			(in thousands)			
Research and development	\$ 1,146	33%	\$ 2,223	24%	\$ (1,077)	(48)%
Selling, general and administrative	2,171	62%	3,205	35%	(1,034)	(32)%
Goodwill impairment loss	1,077	31%			1,077	100%
Impairment of long-lived assets	851	24%			851	100%
Provision for litigation settlement			1,500	16%	(1,500)	(100)%
Total operating expenses	\$ 5,245	149%	\$ 6,928	75%	\$ (1,683)	(24)%

**Research and development.** Our research and development expenses decreased from \$2.2 million for the three months ended May 31, 2012 to \$1.1 million for the three months ended May 31, 2013. The decrease was primarily due to a \$1.1 million decrease in materials and supplies used in research and development, primarily as a result of fewer ongoing research and development activities during the three months ended May 31, 2013. In comparison, the amount of materials and supplies used during the three months ended May 31, 2012 was higher, primarily due to our research and development activities to improve production yields, to enhance the brightness of our chips, to provide continued support of the migration to 4 wafers and to improve our products.

**Selling, general and administrative.** Our selling, general and administrative expenses decreased from \$3.2 million for the three months ended May 31, 2012 to \$2.2 million for the three months ended May 31, 2013. The decrease was mainly attributable to a \$0.7 million decrease in professional service expenses, mainly legal services, a \$0.1 million decrease in salaries, bonuses and other benefits, and decreases in expenses including travel, advertisement and various other expenses as a result of our cost reduction initiatives. We incurred a higher legal service expense for the three months ended May 31, 2012 primarily due to our defense of a patent infringement lawsuit involving Cree, which we settled in June 2012.



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**Goodwill impairment loss.** We recognized a \$1.1 million impairment loss during the three months ended May 31, 2013 on goodwill that arose from our acquisition of a 51% equity interest in Ning Xiang in August 2011. All of the goodwill was assigned to the Ning Xiang reporting unit. The charge, which stemmed primarily from our updated long-term financial forecasts, is more fully described above. See Note 3 in the Notes to the Unaudited Condensed Consolidated Financial Statements of this Quarterly Report.

**Impairment of long-lived assets.** We recognized a \$0.9 million impairment charge during the three months ended May 31, 2013 on the intangible asset for customer relationships that arose from our acquisition of a 51% equity interest in Ning Xiang in August 2011. The charge, which stemmed primarily from our updated long-term financial forecasts that reflected a lower estimated near-term and longer-term revenues and profitability compared to estimates developed at the time of the acquisition in August 2011, is more fully described in Note 3 in the Notes to the Unaudited Condensed Consolidated Financial Statements of this Quarterly Report.

**Provision for litigation settlement.** We recognized a \$1.5 million provision for litigation settlement during the three months ended May 31, 2012. The settlement payment agreed to with Cree was in line with the provision.

Table of Contents**Other Income (Expenses)**

	Three Months Ended May 31,		2012		Change \$	Change %
	2013	% of Revenues	\$	% of Revenues		
	\$		\$			
	(in thousands)					
Impairment loss on investment	\$ (1,885)	(53)%	\$		\$ (1,885)	100%
Equity in losses from unconsolidated entities, net	(74)	(2)%	(2,173)	(24)%	2,099	(97)%
Interest expenses, net	(25)	(1)%	(6)	(0)%	(19)	317%
Other income, net	52	1%	49	1%	3	6%
Foreign currency transaction gain, net	350	10%	10	0%	340	3400%
Total other expenses, net	\$ (1,582)	(45)%	\$ (2,120)	(23)%	\$ 538	(25)%

**Impairment loss on investment.** We recognized a \$1.9 million other-than-temporary impairment loss on our investment in HPO during the three months ended May 31, 2013, as more fully described in Note 4 in the Notes to the Unaudited Condensed Consolidated Financial Statements of this Quarterly Report.

**Equity in losses from unconsolidated entities, net.** We recognized net losses from unconsolidated entities of \$0.1 million for the three months ended May 31, 2013, as compared to \$2.2 million for the three months ended May 31, 2012, primarily because, as described above, we no longer recognize any portion of the net losses reported by China SemiLEDs subsequent to August 31, 2012.

**Foreign currency transaction gain, net.** We recognized a net foreign currency transaction gain of \$0.4 million for the three months ended May 31, 2013, primarily due to the appreciation of the U.S. dollar against the NT dollar from bank deposits held by Taiwan SemiLEDs in currency other than the functional currency of such subsidiary. We recognized an insignificant amount of net foreign currency transaction gain for the three months ended May 31, 2012.

	Three Months Ended May 31,		2012		Change \$	Change %
	2013	% of Revenues	\$	% of Revenues		
	\$		\$			
	(in thousands)					
Income tax expense	\$		\$		\$	

**Income Tax Expense**

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Our effective tax rate is estimated to be approximately zero for fiscal 2013, since it is expected that Taiwan SemiLEDs, our primary operating subsidiary, will incur losses, and because we provided a full valuation allowance on all deferred tax assets, which consist primarily of net operating loss carryforwards and tax credits. Subsidiaries in Taiwan file their income tax returns separately.

Our effective tax rate was approximately zero for fiscal 2012, since Taiwan SemiLEDs incurred losses, and because we provided a full valuation allowance on all deferred tax assets, which consist primarily of net operating loss carryforwards and tax credits.

### *Net Loss Attributable to Noncontrolling Interests*

	Three Months Ended May 31,				Change \$	Change %
	2013	% of Revenues	2012	% of Revenues		
Net loss attributable to noncontrolling interests	\$ (431)	(12)%	\$ (99)	(1)%	\$ (332)	335%

(in thousands)

We recognized a net loss attributable to noncontrolling interests of \$0.4 million and \$0.1 million for the three months ended May 31, 2013 and 2012, respectively, which was attributable to the share of net loss of Ning Xiang held by the remaining noncontrolling holders. Noncontrolling interests represented a 49% of equity interest in Ning Xiang since the date of acquisition, and reduced to 34% beginning in April 2013.

Table of Contents**Nine Months Ended May 31, 2013 Compared to the Nine Months Ended May 31, 2012**

	2013		Nine Months Ended May 31, 2012		Change \$	Change %
	\$	% of Revenues	\$	% of Revenues		
	(in thousands)					
LED chips	\$ 4,543	31%	\$ 5,642	24%	\$ (1,099)	(19)%
LED components	5,787	40%	13,119	55%	(7,332)	(56)%
Lighting products	3,186	22%	3,026	13%	160	5%
Other revenues	1,067	7%	2,043	8%	(976)	(48)%
Total revenues, net	14,583	100%	23,830	100%	(9,247)	(39)%
Cost of revenues	25,781	177%	26,428	111%	(647)	(2)%
Gross loss	\$ (11,198)	(77)%	\$ (2,598)	(11)%	\$ (8,600)	331%

***Revenues, net***

Our revenues decreased by approximately 39% from \$23.8 million for the nine months ended May 31, 2012 to \$14.6 million for the nine months ended May 31, 2013. The \$9.2 million decrease in revenues reflects a \$7.3 million decrease in revenues attributable to sales of LED components, a \$1.1 million decrease in revenues attributable to sales of LED chips and a \$1.0 million decrease in other revenues, offset in part by a \$0.2 million increase in revenues attributable to the sales of lighting products.

Revenues attributable to the sales of our LED chips represented 31% and 24% of our revenues for the nine months ended May 31, 2013 and 2012, respectively. During the nine months ended May 31, 2013, the average selling price of our LED chips was 68% lower as compared to the nine months ended May 31, 2012, but volume of LED chips sold was 1.5-fold higher, primarily due to our decision to phase out and clear a significant volume of older inventory in our LED chips portfolio at discounted prices in a one-time sale. Our introduction of new EV LED chips had rendered such older inventory obsolete. The decrease in the average selling price of LED chips reflected our sales of such older inventory, and also as a result of continued market downward pricing pressure. The decrease in revenues attributable to sales of LED chips was also due to our attempt to direct efforts to areas of business where we see the best opportunity for the most profitable sales of our LED chips. This strategy, however, did not have a positive impact on our revenues during the nine months ended May 31, 2013, primarily because we were unable to develop and expand our customer base and distribution channels in a timely manner, and because we did not obtain qualifications from certain of our existing customers and potential customers on our new EV LED chips and new business initiatives.

Revenues attributable to the sales of our LED components represented 40% and 55% of our revenues for the nine months ended May 31, 2013 and 2012, respectively. The decrease in revenues attributable to sales of LED components was primarily driven by reduced sales of a category of lower-priced LED components that we had previously sold in significant volume to distributor customers during the nine months ended May 31, 2012. During the nine months ended May 31, 2013, the volume of LED components sold was 73% lower, but average selling price of LED components was 59% higher as compared to the nine months ended May 31, 2012, primarily due to a slowdown in customer demand for the lower-priced LED components. The increase in the average selling price of LED components reflected a shift in our product mix to a reduced proportion of such lower-priced LED components.

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Revenues attributable to the sales of lighting products represented 22% and 13% of our revenues for the nine months ended May 31, 2013 and 2012, respectively. The increase in revenues attributable to the sales of lighting products was primarily due to project-based orders for LED lights products during the nine months ended May 31, 2013.

The decrease in other revenues was primarily due to lower sales of scraps and epitaxial wafers.

### *Cost of Revenues*

Our cost of revenues decreased by 2% from \$26.4 million for the nine months ended May 31, 2012 to \$25.8 million for the nine months ended May 31, 2013. The decrease in cost of revenues was primarily due to lower sales during the nine months ended May 31, 2013, as more fully described above. The decreases, however, were offset in part by increases in excess capacity charges, primarily for our LED chips, and increases in cost of revenues driven primarily by volume of LED chips sold as a result of inventory clearance and increased sales of LED lights products. Factory utilization was lower during the nine months ended May 31, 2013, primarily due to lower sales and our decision to work down our inventory levels for our LED chips.

Table of Contents**Gross Loss**

Our gross loss increased from a loss of \$2.6 million for the nine months ended May 31, 2012 to a loss of \$11.2 million for the nine months ended May 31, 2013. Our gross margin percentage was negative 77% for the nine months ended May 31, 2013, as compared to negative 11% for the nine months ended May 31, 2012, as a consequence of the reduction in revenues and excess capacity charge for our LED chips, as more fully described above.

**Operating Expenses**

	2013		Nine Months Ended May 31, 2012		Change \$	Change %
	\$	% of Revenues	\$	% of Revenues		
			(in thousands)			
Research and development	\$ 3,403	23%	\$ 5,935	25%	\$ (2,532)	(43)%
Selling, general and administrative	8,454	58%	10,155	43%	(1,701)	(17)%
Goodwill impairment loss	1,077	7%			1,077	100%
Impairment of long-lived assets	851	6%			851	100%
Provision for litigation settlement			1,500	6%	(1,500)	(100)%
Total operating expenses	\$ 13,785	95%	\$			