EMCORE CORP
Form 10-Q
August 09, 2006

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

FORM 10-Q

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

For the quarterly period ended: **June 30, 2006**

Commission File Number: **0-22175**

EMCORE Corporation
(Exact name of Registrant as specified in its charter)

New Jersey
(State or other jurisdiction of incorporation or organization)

22-2746503
(IRS Employer Identification No.)

145 Belmont Drive, Somerset, NJ 08873
(Address of principal executive offices)

(732) 271-9090
(Registrant's telephone number)

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. **x Yes** **o** No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (check one): o Large accelerated filer x **Accelerated filer** **o** Non-accelerated filer

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

The number of shares outstanding of the registrant’s no par value common stock as of August 4, 2006 was 50,889,524.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

EMCORE CORPORATION
Condensed Consolidated Statements of Operations
For the three and nine months ended June 30, 2006 and 2005
(in thousands, except per share data)
(unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Revenue	$ 41,954	$ 33,234	$ 123,007	$ 90,628
Cost of revenue	33,336	26,503	98,864	76,293
Gross profit	8,618	6,731	24,143	14,335
Operating expenses:				
Selling, general and administrative	8,182	7,902	26,445	18,589
Research and development	5,152	4,061	14,550	13,189
Total operating expenses	13,334	11,963	40,995	31,778
Operating loss	(4,716)	(5,232)	(16,852)	(17,443)
Other (income) expenses:				
Interest income	(263)	(297)	(838)	(779)
Interest expense	1,331	1,202	3,987	3,606
Loss from convertible subordinated notes exchange offer	-	-	1,078	-
Equity in net loss of Velox investment	-	-	332	-
Equity in net loss (income) of GELcore investment	129	778	(21)	703
Total other expenses	1,197	1,683	4,538	3,530
Loss from continuing operations	(5,913)	(6,915)	(21,390)	(20,973)
Discontinued operations:				
Gain on disposal of discontinued operations	-	-	2,012	12,476
Income from discontinued operations	-	-	2,012	12,476
Net loss	$ (5,913)	$ (6,915)	$ (19,378)	$ (8,497)
Per share data:				
Basic and diluted per share data:				
Loss from continuing operations	$ (0.12)	$ (0.15)	$ (0.43)	$ (0.44)
Income from discontinued operations	-	-	0.04	0.26

Net loss	$ (0.12)	$ (0.15)	$ (0.39)	$ (0.18)
Weighted average number of shares outstanding used in basic and diluted per share calculations	50,430	47,426	49,336	47,228

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

EMCORE CORPORATION
Condensed Consolidated Balance Sheets
As of June 30, 2006 and September 30, 2005
(in thousands)
(unaudited)

	As of June 30, 2006	As of September 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,138	$ 19,525
Restricted cash	1,303	547
Marketable securities	7,900	20,650
Accounts receivable, net	27,388	22,633
Receivables, related parties	482	4,197
Inventory, net	24,940	18,348
Prepaid expenses and other current assets	3,224	3,638
Total current assets	81,375	89,538
Property, plant and equipment, net	56,997	56,957
Goodwill	40,476	34,643
Intangible assets, net	6,624	5,347
Investments in unconsolidated affiliates	12,388	12,698
Receivables, related parties	169	169
Other assets, net	5,526	6,935
Total assets	$ 203,555	$ 206,287
LIABILITIES and SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 20,692	$ 15,587
Accrued expenses and other current liabilities	13,540	19,078
Notes payable, current portion	430	-
Convertible subordinated notes, current portion	-	1,350
Total current liabilities	34,662	36,015
Notes payable, long-term	277	-
Convertible subordinated notes, long-term	95,895	94,709
Total liabilities	130,834	130,724
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $0.0001 par, 5,882 shares authorized, no shares outstanding	-	-
Common stock, no par value, 100,000 shares authorized, 50,805 shares issued and 50,646 shares outstanding at June 30, 2006;	410,153	392,466

48,023 shares issued and 48,003 shares outstanding at September 30, 2005		
Accumulated deficit	(335,349)	(315,971)
Treasury stock, at cost 159 shares at June 30, 2006; 20 shares at September 30, 2005	(2,083)	(932)
Total shareholders' equity	72,721	75,563
Total liabilities and shareholders' equity	$ 203,555	$ 206,287

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

EMCORE CORPORATION
Condensed Consolidated Statements of Cash Flows
For the nine months ended June 30, 2006 and 2005
(in thousands)
(unaudited)

	Nine Months Ended June 30, 2006	Nine Months Ended June 30, 2005
Cash flows from operating activities:		
Net loss	$ (19,378)	$ (8,497)
Adjustments to reconcile net loss to net cash used for operating activities:		
Gain on disposal of discontinued operations	(2,012)	(12,476)
Stock option compensation expense	3,086	-
Depreciation and amortization expense	10,297	10,861
Accretion of loss from convertible subordinated notes exchange offer	116	-
Loss on convertible subordinated notes exchange offer	1,078	-
Provision for doubtful accounts	56	(170)
Equity in net (income) loss of GELcore	(21)	703
Equity in net loss of Velox	332	-
Compensatory stock issuances	591	579
Forgiveness of shareholders’ notes receivable	2,613	34
Reduction of note receivable due for services received	390	390
Total non-cash adjustments	16,526	(79)
Changes in operating assets and liabilities:		
Accounts receivable	(4,072)	(6,328)
Receivables, related parties	(49)	(317)
Inventory	(5,931)	(2,761)
Prepaid expenses and other current assets	389	941
Other assets	(928)	(402)
Accounts payable	3,320	(2,070)
Accrued expenses and other current liabilities	(7,904)	(1,664)
Total change in operating assets and liabilities	(15,175)	(12,601)
Net cash used for operating activities	(18,027)	(21,177)
Cash flows from investing activities:		
Cash proceeds from disposition of discontinued operations	-	13,197
Investment in GELcore	-	(1,470)
Purchase of plant and equipment	(4,008)	(3,280)
Proceeds from (investment in) K2 Optronics	500	(1,000)
Cash purchase of businesses, net of cash acquired	610	(2,783)
Purchase of marketable securities	(350)	(11,225)
Funding of restricted cash	(703)	-
Sale of marketable securities	13,100	22,875
Net cash provided by investing activities	9,149	16,314
Cash flows from financing activities:		
Payments on debt obligations	(176)	(31)

Proceeds from exercise of stock options		6,023		503
Proceeds from employee stock purchase plan		1,108		1,006
Convertible debt/equity issuance costs		(114)		-
Principal payment on convertible debt obligation		(1,350)		-
Net cash provided by financing activities		5,491		1,478
Net decrease in cash and cash equivalents		(3,387)		(3,385)
Cash and cash equivalents, beginning of period		19,525		19,422
Cash and cash equivalents, end of period	$	16,138	$	16,037
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION				
Cash paid during the period for interest	$	5,067	$	4,806
Issuance of common stock in conjunction with acquisitions	$	6,460	$	-
NON-CASH INVESTING AND FINANCING ACTIVITIES				
Acquisition of property and equipment under capital leases	$	126	$	-
Net decrease in liabilities for purchase of plant and equipment	$	670	$	-
Manufacturing equipment received in lieu of earn-out proceeds from disposition of discontinued operations	$	2,012	$	-

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

EMCORE Corporation
Notes to Condensed Consolidated Financial Statements
As of June 30, 2006 and September 30, 2005 and
For the three and nine months ended June 30, 2006 and 2005
(unaudited)

NOTE 1. Basis of Presentation.

The accompanying unaudited condensed consolidated financial statements include the accounts of EMCORE Corporation and its subsidiaries (EMCORE). All intercompany accounts and transactions have been eliminated. Certain amounts in prior period financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported shareholders' equity.

These statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim information, and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by US GAAP for annual financial statements. In the opinion of management, all information considered necessary for a fair presentation of the financial statements has been included. Operating results for interim periods are not necessarily indicative of results that may be expected for an entire fiscal year. The condensed consolidated balance sheet as of September 30, 2005 has been derived from the audited financial statements as of such date. For a more complete understanding of EMCORE's financial position, operating results, risk factors and other matters, please refer to EMCORE's Annual Report on Form 10-K for the fiscal year ended September 30, 2005.

The preparation of financial statements in conformity with US 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 financial statements and the reported amounts of revenues and expenses during the reported period. Management bases estimates on historical experience and on various assumptions about the future that are believed to be reasonable based on available information. EMCORE's reported financial position or results of operations may be materially different under changed conditions or when using different estimates and assumptions. In the event that estimates or assumptions prove to differ from actual results, adjustments are made in subsequent periods to reflect more current information.

NOTE 2. Recent Accounting Pronouncements.

SFAS No. 123(R) - Effective October 1, 2005, EMCORE adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment (Revised 2004),* on a modified prospective basis. As a result, EMCORE included stock-based compensation expense in its results of operations for all periods presented in fiscal 2006, as more fully described in Note 3 to EMCORE's condensed consolidated financial statements.

SFAS No. 151 - Effective October 1, 2005, EMCORE adopted SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal". In addition, it requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of this pronouncement did not have a material impact on EMCORE's financial statements.

SFAS No. 154 - Effective October 1, 2005, EMCORE adopted SFAS No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes,* and Financial Accounting Standards Board (FASB) Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. The Statement applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. Opinion 20 previously required that such a change be reported as a change in accounting principle. The adoption of this pronouncement did not have a material impact on EMCORE's financial statements.

FIN 47 - Effective October 1, 2005, EMCORE adopted FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143*. This interpretation clarifies the timing of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligations are conditional on a future event and where an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The adoption of this pronouncement did not have a material impact on EMCORE's financial statements.

FIN 48 - In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 applies to all tax positions related to income taxes subject to FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. EMCORE does not believe the adoption of FIN 48 on October 1, 2007 will have a material impact on its financial statements.

EITF No. 05-6 - In June 2005, the Emerging Issues Task Force (EITF) issued No. 05-6, *Determining the Amortization Period for Leasehold Improvements*. The pronouncement requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of the lease be amortized over the lesser of the useful life of the asset or the lease term that includes reasonably assured lease renewals as determined on the date of the acquisition of the leasehold improvement. This pronouncement should be applied prospectively and EMCORE adopted it during the first quarter of fiscal 2006. This pronouncement did not have a material impact on the financial statements.

FSP 115-1 - In November 2005, FASB issued Staff Position (FSP) 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosure about unrealized losses that have not been recognized as other-than-temporary impairments. FSP 115-1 is effective for annual reporting periods beginning after December 15, 2005. EMCORE does not believe the adoption of FSP 115-1 on October 1, 2006 will have a material impact on its financial statements.

NOTE 3. Stock-based Compensation.

Stock Options

EMCORE has stock option plans to provide long-term incentives to eligible employees, officers, and directors in the form of stock options. Most of the stock options vest and become exercisable over four to five years and have ten-year terms. EMCORE maintains two incentive stock option plans: the 2000 Stock Option Plan (2000 Plan), and the 1995 Incentive and Non-Statutory Stock Option Plan (1995 Plan and, together with the 2000 Plan, the Option Plans). The 1995 Plan authorizes the grant of options to purchase up to 2,744,118 shares of EMCORE's common stock. As of June 30, 2006, no options were available for issuance under the 1995 Plan. The 2000 Plan authorizes the grant of options to purchase up to 9,350,000 shares of EMCORE's common stock. As of June 30, 2006, 1,433,874 options were available for issuance under the 2000 Plan. Certain options under the Option Plans are intended to qualify as incentive stock options pursuant to Section 422A of the Internal Revenue Code.

During the three and nine months ended June 30, 2006, 211,750 and 1,740,707 options were granted pursuant to the 2000 Plan, respectively. All options were issued at the closing market price on the date of grant. The stock option issue prices for the three months ended June 30, 2006 ranged from $7.97 to $12.57 per share. The stock option issue prices for the nine months ended June 30, 2006 ranged from $5.18 to $12.57 per share. These options are subject to a five-year vesting period for new-hire grants and a four-year vesting period for retention grants, and have a contractual life of ten years. The weighted average grant date fair value for the options issued during the three and nine months ended June 30, 2006 was $7.89 and $6.33, respectively. No executive officers received any stock option grants during fiscal 2006. As of June 30, 2006, 2,408,896 options were exercisable. EMCORE issues new shares of common stock upon exercise of stock options.

The following table summarizes the activity under the Option Plans:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of September 30, 2005	6,166,226	$ 4.16		
Granted	1,740,707	7.93		
Exercised	(1,524,542)	3.95		
Cancelled	(222,409)	3.46		
Outstanding as of June 30, 2006	6,159,982	$ 5.30	7.46	$ 29,345
Exercisable as of June 30, 2006	2,408,896	$ 5.53	5.36	$ 12,629
Non-vested as of June 30, 2006	3,751,086	$ 5.16	8.81	$ 16,716

As of June 30, 2006 there was $12.7 million of total unrecognized compensation expense related to non-vested share-based compensation arrangements granted under the Option Plans. This expense is expected to be recognized over a weighted average life of 3.3 years. The total intrinsic value of options exercised during the three and nine months ended June 30, 2006 was $1.6 million and $7.4 million, respectively. The total fair value of shares vested during the three and nine months ended June 30, 2006 was $0.9 million and $2.6 million, respectively. EMCORE received $0.6 million and $6.0 million in cash from the exercise of stock options during the three and nine months ended June 30, 2006, respectively.

At June 30, 2006, stock options outstanding were as follows:

Exercise Price

	Options Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
<$1	1,920	1.43	$0.23
>$1 to <$5	3,572,590	7.39	2.70
>$5 to <$10	2,332,582	7.92	7.60
>$10	252,890	4.42	20.88
	6,159,982	7.46	$5.30

At June 30, 2006, stock options exercisable were as follows:

Exercise Price	Options Exercisable	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
<$1	1,920	1.43	$0.23
>$1 to <$5	1,504,644	6.34	2.37
>$5 to <$10	675,992	3.73	7.03
>$10	226,340	3.79	22.07
	2,408,896	5.36	$5.53

<u>Employee Stock Purchase Plan</u>

In fiscal 2000, EMCORE adopted an Employee Stock Purchase Plan (ESPP). The ESPP provides employees of EMCORE an opportunity to purchase common stock through payroll deductions. The ESPP is a 6-month duration plan, with new participation periods beginning the first business day of January and July of each year. The purchase price is set at 85% of the market price for EMCORE's common stock on either the first or last day of the participation period, whichever is lower and contributions are limited to 10% of an employee's compensation. The number of shares of common stock available for issuance under the ESPP is 2,000,000 shares. The amount of shares issued for the ESPP are as follows:

	Number of Shares
Amount of shares reserved for the ESPP	2,000,000
Number of shares issued in December 2000 for calendar year 2000	(16,534)
Number of shares issued in December 2001 for calendar year 2001	(48,279)
Number of shares issued in December 2002 for calendar year 2002	(89,180)
Number of shares issued in December 2003 for calendar year 2003	(244,166)
Number of shares issued in June 2004 for first half of calendar year 2004	(166,507)
Number of shares issued in December 2004 for second half of calendar year 2004	(167,546)
Number of shares issued in June 2005 for first half of calendar year 2005	(174,169)
Number of shares issued in December 2005 for second half of calendar year 2005	(93,619)
Number of shares issued in June 2006 for first half of calendar year 2006	(123,857)

Remaining shares reserved for the ESPP as of June 30, 2006	876,143

Future Issuances

As of June 30, 2006, EMCORE has reserved a total of 20,841,970 shares of its common stock for future issuances as follows:

	Number of Shares
For exercise of outstanding warrants to purchase common stock	31,535
For exercise of outstanding common stock options	6,159,982
For conversion of subordinated notes	12,016,930
For future issuances to employees under the ESPP plan	876,143
For future common stock option awards	1,433,874
Total reserved	20,518,464

Valuation of Stock-Based Compensation

Effective October 1, 2005, EMCORE adopted SFAS 123(R), using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation expense is measured at grant date, based on the fair value of the award, over the requisite service period. EMCORE previously applied Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*.

Periods prior to the adoption of SFAS 123(R) - Prior to the adoption of SFAS 123(R), EMCORE provided the disclosures required under SFAS No. 123 as amended by SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosures*. EMCORE did not recognize stock-based compensation expense in its statement of operations for periods prior to the adoption of SFAS 123(R) since options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and net loss per share as if EMCORE had applied the fair value recognition provisions of SFAS 123(R) to options granted under EMCORE's stock-based compensation plans prior to the adoption. For purposes of this pro forma disclosure, the value of the options was estimated using a Black-Scholes option pricing formula and amortized on a straight-line basis over the respective vesting periods of the awards. Disclosures for the three months and nine months ended June 30, 2006 are not presented because stock-based compensation was accounted for under SFAS 123(R)'s fair-value method during this period.

(*in thousands, except per share amounts*)	**Three Months Ended June 30, 2005**	**Nine Months Ended June 30, 2005**
Reported net loss	$ (6,915)	$ (8,497)
Less:		
Pro forma stock-based compensation expense determined under the fair value based method, net of tax	(788)	(2,132)

Pro forma net loss	$	(7,703)	$	(10,629)
Reported net loss per basic and diluted share	$	(0.15)	$	(0.18)
Pro forma net loss per basic and diluted share	$	(0.16)	$	(0.23)

<u>Adoption of SFAS 123(R)</u> - During the three and nine months ended June 30, 2006, EMCORE recorded stock-based compensation expense totaling $1.0 million and $3.1 million, respectively. As required by SFAS 123(R), management has made an estimate of expected forfeitures and is recognizing compensation expense only for those equity awards expected to vest. The effect of recording stock-based compensation expense for the three and nine months ended June 30, 2006 was as follows:

(*in thousands, except per share amounts*)		**Three Months Ended June 30, 2006**		**Nine Months Ended June 30, 2006**
Stock-based compensation expense by award type:				
Employee stock options	$	(904)	$	(2,557)
Employee stock purchase plan		(119)		(529)
Total stock-based compensation expense	$	(1,023)	$	(3,086)
Net effect on net loss per basic and diluted share	$	(0.02)	$	(0.06)

The stock-based compensation expense for the three and nine months ended June 30, 2006 was distributed as follows:

Stock-Based Compensation Expense by Segment
For the three months ended June 30, 2006

(*in thousands*)		**COGS**		**SG&A**		**R&D**		**Total**
Fiber Optics	$	202	$	257	$	255	$	714
Photovoltaics		52		117		44		213
Electronic Materials and Devices		41		28		27		96
Total stock-based compensation expense	$	295	$	402	$	326	$	1,023

Stock-Based Compensation Expense by Segment
For the nine months ended June 30, 2006

(*in thousands*)		**COGS**		**SG&A**		**R&D**		**Total**
Fiber Optics	$	494	$	1,014	$	677	$	2,185
Photovoltaics		125		409		89		623
Electronic Materials and Devices		92		115		71		278

Total stock-based compensation expense	$ 711	$ 1,538	$ 837	$ 3,086

Valuation Assumptions

EMCORE estimated the fair value of stock options using a Black-Scholes model. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model and the straight-line attribution approach using the following weighted-average assumptions:

Stock Option Plans	**Three Months Ended June 30,**		**Nine Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Expected dividend yield	0%	0%	0%	0%
Expected stock price volatility	97%	106%	97%	106%
Risk-free interest rate	4.7%	3.9%	4.7%	3.8%
Expected term (in years)	6	5	6	5

Expected Dividend Yield: The Black-Scholes valuation model calls for a single expected dividend yield as an input. EMCORE has not issued any dividends.

Expected Stock Price Volatility: The fair values of stock based payments were valued using the Black-Scholes valuation method with a volatility factor based on EMCORE's historical stock prices.

Risk-Free Interest Rate: EMCORE bases the risk-free interest rate used in the Black-Scholes valuation method on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term. Where the expected term of EMCORE's stock-based awards do not correspond with the terms for which interest rates are quoted, EMCORE performed a straight-line interpolation to determine the rate from the available maturities.

Expected Term: EMCORE's expected term represents the period that EMCORE's stock-based awards are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its stock-based awards.

Estimated Pre-vesting Forfeitures: When estimating forfeitures, EMCORE considers voluntary termination behavior as well as future workforce reduction programs.

NOTE 4. Investments.

In January 1999, General Electric Lighting and EMCORE formed GELcore, a joint venture to address the solid-state lighting market with high-brightness light-emitting diode-based (HB-LED) lighting systems. General Electric Lighting and EMCORE have agreed that this joint venture will be the exclusive vehicle for each party's participation in solid-state lighting. EMCORE has a 49% non-controlling interest in the GELcore venture, and accounts for this investment using the equity method of accounting. As of June 30, 2006, EMCORE's net investment in this joint venture amounted to approximately $11.4 million.

In April 2005, EMCORE divested product technology focused on gallium nitride (GaN)-based power electronic devices for the power device industry. The new company, Velox Semiconductor Corporation (Velox), raised $6.0 million from various venture capital partnerships. Five EMCORE employees transferred to Velox as full-time personnel and EMCORE contributed intellectual property and equipment receiving a 19.2% stake in Velox. For the three months ended December 31, 2005 and March 31, 2006, EMCORE had recognized a loss of $0.2 million and $0.1 million, respectively, related to Velox, which was recorded as a component of other income and expenses. During fiscal 2006, EMCORE reduced its voting percentage and relinquished its Velox Board seat, and its right to a Velox Board seat. As a result of these modifications, EMCORE now reports its investment in Velox under the cost method of accounting rather than the equity method of accounting. Under the cost method of accounting, the Velox investment will be carried at cost and adjusted only for other-than-temporary declines in fair value, distribution of earnings and additional investments. As of June 30, 2006, EMCORE's net investment in Velox amounted to approximately $1.0 million.

NOTE 5. Acquisitions.

On January 12, 2006, EMCORE entered into an Agreement and Plan of Merger (Merger Agreement) with K2 Optronics, Inc. (K2), a privately held company located in Sunnyvale, CA and EMCORE Optoelectronics Acquisition Corporation, a wholly owned subsidiary of EMCORE (Merger Sub). Pursuant to the Merger Agreement, EMCORE acquired K2 in a transaction in which Merger Sub merged with and into K2, with K2 becoming a wholly owned subsidiary of EMCORE. EMCORE, an investor in K2, paid approximately $4.1 million in EMCORE common stock, and paid approximately $0.7 million in transaction-related expenses, to acquire the remaining part of K2 that EMCORE did not already own. Prior to the transaction EMCORE owned a 13.6% equity interest in K2 as a result of a $1.0 million investment that EMCORE made in K2 in October 2004. In addition, K2 was a supplier to EMCORE of analog external cavity lasers for CATV applications. In connection with the merger, EMCORE issued a total of 548,688 shares of EMCORE common stock, no par value, (based on a 20-trading day weighted average price), to K2's shareholders. EMCORE has filed a shelf registration statement with respect to the resale of the EMCORE shares on July 7, 2006. Including EMCORE's initial $1.0 million investment in K2, the purchase price, on a preliminary basis, was allocated as follows: $1.1 million in cash, $0.1 million in other current assets, $0.8 million in fixed assets, $1.5 million in intellectual property, $2.4 million in accounts payable and accrued liabilities, $0.8 million in debt and $4.8 million in residual goodwill. Furthermore, in connection with this K2 acquisition, EMCORE and JDS Uniphase (JDSU) amended their May 2005 Purchase Agreement relating to EMCORE's acquisition of JDSU's analog CATV and RF over fiber specialty businesses. As a result, JDSU retained its K2 investment (on a pre-merger basis), and repaid $0.5 million to EMCORE.

On November 8, 2005, EMCORE entered into an Asset Purchase Agreement with Phasebridge, Inc., a privately held company located in Pasadena, California. In connection with the asset purchase, based on a 10-trading day weighted average price, EMCORE issued 128,205 shares of EMCORE common stock, no par value, that were valued in the transaction at $0.7 million. The acquisition included Phasebridge's products, technical and engineering staff, certain assets and intellectual properties and technologies. On a preliminary basis, the purchase price was allocated as follows: $0.1 million in fixed assets, $0.7 million in intellectual property and $0.1 million in accrued liabilities.

On December 18, 2005, EMCORE entered into an Asset Purchase Agreement with Force, Inc., a privately held company located in Christiansburg, Virginia. In connection with the asset purchase, EMCORE issued 240,000 shares of EMCORE common stock, no par value, with a market value of $1.6 million at the measurement date and $0.5 million in cash. The acquisition included Force's fiber optic transport and video broadcast products, technical and engineering staff, certain assets and intellectual properties and technologies. On a preliminary basis, the purchase price was allocated as follows: $0.4 million in accounts receivable, $0.8 million in inventory, $0.2 million in fixed assets, $1.2 million in intellectual property, $1.3 million in accounts payable and accrued liabilities and $0.8 million in residual goodwill.

These transactions were accounted for as purchases in accordance with SFAS No. 141, *Business Combinations*; therefore, the tangible assets acquired were recorded at fair value on the acquisition date. These acquisitions were not significant on a pro-forma basis, and therefore, pro-forma financial statements are not provided. The operating results of the businesses acquired are included in the accompanying consolidated statement of operations from the date of acquisition. The primary areas of the purchase price allocations that are not yet finalized relate to the valuation of accrued liabilities, intellectual property, and residual goodwill. The acquired businesses are part of EMCORE's Fiber Optics operating segment.

NOTE 6. Discontinued Operations.

In November 2003, EMCORE sold its TurboDisc capital equipment business in an asset sale to a subsidiary of Veeco Instruments Inc. (Veeco). The selling price was $60.0 million in cash at closing, with a potential additional earn-out up to $20.0 million over the next two years, calculated based on the net sales of TurboDisc products. In March 2005, EMCORE received $13.2 million of earn-out payment from Veeco in connection with its first year of net sales of TurboDisc products. After offsetting this receipt against expenses related to the discontinued operation, EMCORE recorded a net gain from the disposal of discontinued operations of $12.5 million. In March 2006, EMCORE earned $2.0 million as a final earn-out payment from Veeco in connection with Veeco's second year of net sales of TurboDisc products. The cumulative additional earn-out totaled $15.2 million or 76% of the maximum available payout of $20.0 million.

NOTE 7. Receivables.

Accounts receivable consisted of the following:

Accounts Receivable, net *(in thousands)*	**As of June 30, 2006**	**As of September 30, 2005**
Accounts receivable	$ 25,977	$ 21,721
Accounts receivable - unbilled	1,732	1,240
Subtotal	27,709	22,961
Allowance for doubtful accounts	(321)	(328)
Total	$ 27,388	$ 22,633

In September 2005, EMCORE entered into a non-recourse receivables purchase agreement (AR Agreement) with Silicon Valley Bank (SVBank). Under the terms of the AR Agreement, EMCORE from time to time may sell, without recourse, certain account receivables to SVBank up to a maximum aggregate outstanding amount of $20.0 million. The AR Agreement expires on December 31, 2006, unless the term is extended by mutual agreement by all parties. In June 2006 and September 2005, EMCORE sold approximately $6.5 million and $2.2 million of account receivables to SVBank, respectively.

Receivables from related parties consisted of the following:

Receivables, Related Parties *(in thousands)*	**As of June 30, 2006**	**As of September 30, 2005**
Current assets:		

GELcore-related	$	200	$	185
Velox-related		282		249
Employee loans		-		3,000
Employee loans - interest portion		-		763
Subtotal		482		4,197
Long-term assets:				
Employee loans		169		169
Total	$	651	$	4,366

Employee Loans

From time to time, prior to July 2002, EMCORE loaned money to certain of its executive officers and directors. Pursuant to due authorization from EMCORE's Board of Directors, EMCORE loaned $3.0 million to Mr. Reuben Richards, the Chief Executive Officer in February 2001 (Note). The Note matured on February 22, 2006 and bore interest compounded at a rate of (a) 5.18% per annum through May 23, 2002 and (b) 4.99% from May 24, 2002 through maturity. All interest was payable at maturity. On February 13, 2006, Mr. Richards tendered 139,485 shares of EMCORE common stock in partial payment of the Note. Principal plus accrued interest on the Note totaled approximately $3.83 million. The Compensation Committee of EMCORE's Board of Directors specifically approved the tender of shares, as permitted by the Note, at the price of $8.25 per share, which was the closing price of EMCORE common stock on February 13, 2006. On February 28, 2006, the Compensation Committee resolved to forgive the remaining balance of the Note (approximately $2.7 million), effective as of March 10, 2006. Mr. Richards' tender of common stock on February 13, 2006 was accepted as full payment and satisfaction of the Note, including principal and accrued interest. Additionally, the Compensation Committee resolved to accelerate and vest the final tranche of each of the incentive stock option grants made in fiscal 2004 and 2005 to Mr. Richards, which constitute a combined accelerated vesting of 111,250 shares. In considering this matter, the Compensation Committee carefully considered Mr. Richards' past performance, including the recent appreciation in the stock price and EMCORE's improved financial performance, the facts and circumstances surrounding the loan, Mr. Richards' current compensation, Mr. Richards' willingness to repay a portion of the Note and all resulting taxes totaling $1.3 million, and the desire to retain Mr. Richards' continued service to EMCORE. EMCORE recorded a one-time, non-cash charge of approximately $2.7 million in March 2006 for the partial forgiveness of the Note, plus a non-cash charge of approximately $0.3 million in stock-based compensation expense under SFAS 123(R) relating to the accelerated ISO grants.

In addition, pursuant to due authorization of EMCORE's Board of Directors, EMCORE also loaned $82,000 to the Chief Financial Officer (CFO) of EMCORE in December 1995. This loan does not bear interest and provides for offset of the loan via bonuses payable to the CFO over a period of up to 25 years. The remaining related party receivable balance of $87,260 relates to multiple loans from EMCORE to an officer (who is not an executive officer) that were made during 1997 through 2000 and are payable on demand.

NOTE 8. Inventory, net.

Inventory is stated at the lower of cost or market, with cost being determined using the standard cost method that includes material, labor and manufacturing overhead costs. Inventory consisted of the following:

Inventory, net *(in thousands)*	**As of June 30, 2006**	**As of September 30,**

		2005
Raw materials	$ 18,430	$ 15,482
Work-in-process	4,323	5,101
Finished goods	8,930	5,911
Subtotal	31,683	26,494
Less: reserves	(6,743)	(8,146)
Total	$ 24,940	$ 18,348

NOTE 9. Property, Plant and Equipment, net.

Property, plant and equipment consisted of the following:

Property, Plant and Equipment, net *(in thousands)*	**As of June 30, 2006**	**As of September 30, 2005**
Land	$ 1,502	$ 1,502
Building and improvements	39,730	37,944
Equipment	71,844	71,854
Furniture and fixtures	5,639	5,002
Leasehold improvements	3,170	2,935
Construction in progress	8,618	3,390
Property and equipment under capital lease	466	466
Subtotal	130,969	123,093
Less: accumulated depreciation and amortization	(73,972)	(66,136)
Total	$ 56,997	$ 56,957

NOTE 10. Goodwill and Intangible Assets, net.

The following table sets forth changes in the carrying value of goodwill by reportable segment:

(in thousands)	**Fiber Optics**	**Photovoltaics**	**Total**
Balance as of September 30, 2005	$ 14,259	$ 20,384	$ 34,643
Acquisition - Force Inc.	800	-	800
Acquisition - JDSU CATV purchase price adjustment	20	-	20
Acquisition - K2 Optronics	4,750	-	4,750
Acquisition - Earn out payments	263	-	263
Balance as of June 30, 2006	$ 20,092	$ 20,384	$ 40,476

The following table sets forth changes in the carrying value of intangible assets by reportable segment:

(in thousands)	As of June 30, 2006			As of September 30, 2005		
	Gross Assets	**Accumulated Amortization**	**Net Assets**	**Gross Assets**	**Accumulated Amortization**	**Net Assets**
Fiber Optics:						
Patents	$ 495	$ (192)	$ 303	$ 368	$ (136)	$ 232
Ortel acquired IP	3,274	(2,232)	1,042	3,274	(1,746)	1,528
JDSU acquired IP	1,040	(264)	776	1,650	(110)	1,540
Alvesta acquired IP	193	(138)	55	193	(107)	86
Molex acquired IP	558	(307)	251	558	(223)	335
Corona acquired IP	1,000	(417)	583	1,000	(267)	733
Phasebridge acquired IP	700	(108)	592	-	-	-
Force acquired IP	1,200	(161)	1,039	-	-	-
K2 Optronics acquired IP	1,500	(141)	1,359	-	-	-
Subtotal	9,960	(3,960)	6,000	7,043	(2,589)	4,454
Photovoltaics:						
Patents	352	(144)	208	271	(101)	170
Tecstar acquired IP	1,900	(1,663)	237	1,900	(1,350)	550
Subtotal	2,252	(1,807)	445	2,171	(1,451)	720
Electronic Materials & Devices:						
Patents	433	(254)	179	390	(217)	173
Total	$ 12,645	$ (6,021)	$ 6,624	$ 9,604	$ (4,257)	$ 5,347

Based on the carrying amount of the intangible assets, the estimated future amortization expense is as follows:

Amortization Expense *(in thousands)*	
Period ending:	
3-month period ended September 30, 2006	$ 644
Year ended September 30, 2007	2,174
Year ended September 30, 2008	1,505
Year ended September 30, 2009	1,104
Year ended September 30, 2010	855
Thereafter	342
Total future amortization expense	$ 6,624

NOTE 11. Accrued Expenses and Other Current Liabilities.

The components of accrued expenses and other current liabilities consisted of the following:

Accrued Expenses and Other Current Liabilities	**As of**	**As of**

(in thousands)	**June 30, 2006**	**September 30, 2005**
Compensation-related	$ 4,909	$ 4,974
Interest	619	1,814
Warranty	1,072	1,268
Deferred revenue and customer deposits	697	1,539
Professional fees	671	1,082
Royalty	475	551
Acquisition-related	2,351	5,006
Self insurance	817	646
Other	1,929	2,198
Total	$ 13,540	$ 19,078

Product Warranty Reserves. EMCORE provides its customers with limited rights of return for non-conforming shipments and warranty claims for certain products. In accordance with FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* EMCORE makes estimates using historical experience rates as a percentage of revenue and accrues estimated warranty expense as a cost of revenue. Warranty obligations are estimated based on historical experience of known product failure rates, use of materials to repair or replace defective products and service delivery costs incurred in correcting product failures. In addition, from time to time, specific warranty accruals may be made if unforeseen technical problems arise. Should actual experience relative to these factors differ from estimates, additional warranty reserves may be required. Alternatively, if more reserves were estimated than needed, a portion of such provisions may be reversed in future periods. The following table sets forth changes in the product warranty accrual account:

Warranty Reserve
(in thousands)

Balance as of October 1, 2005	$ 1,268
Accruals for warranty expense	192
Reversals due to use or expiration of liability	(388)
Balance as of June 30, 2006	$ 1,072

NOTE 12. Convertible Subordinated Notes.

In May 2001, EMCORE issued $175.0 million aggregate principal amount of its 5% convertible subordinated notes due in May 2006 (2006 Notes). In December 2002, EMCORE purchased $13.2 million principal amount of the 2006 Notes at prevailing market prices for an aggregate of approximately $6.3 million, resulting in a gain of approximately $6.6 million after netting unamortized debt issuance costs of approximately $0.3 million. In February 2004, EMCORE exchanged approximately $146.0 million, or 90.2%, of its remaining 2006 Notes for approximately $80.3 million aggregate principal amount of new 5% Convertible Senior Subordinated Notes due May 15, 2011 (2011 Notes) and approximately 7.7 million shares of EMCORE common stock. Interest on the 2011 Notes is payable in arrears semiannually on May 15 and November 15 of each year. The notes are convertible into EMCORE common stock at a conversion price of $8.06 per share, subject to adjustment under customary anti-dilutive provisions. They also are redeemable should EMCORE's common stock price reach $12.09 per share. As a result of this transaction, EMCORE reduced debt by approximately $65.7 million, and recorded a gain from early debt extinguishment of approximately $12.3 million.

In November 2005, EMCORE exchanged $14,425,000 aggregate principal amount of EMCORE’s 2006 Notes for $16,580,460 aggregate principal amount of newly issued Convertible Senior Subordinated Notes due May 15, 2011 (New 2011 Notes) pursuant to an Exchange Agreement (Agreement) with Alexandra Global Master Fund Ltd. (Alexandra). The terms of the New 2011 Notes are identical in all material respects to EMCORE’s 2011 Notes. The New 2011 Notes are ranked pari passu with the existing 2011 Notes. The New 2011 Notes will be convertible at any time prior to maturity, unless previously redeemed or repurchased by EMCORE, into the shares of EMCORE common stock, no par value, at the conversion rate of 124.0695 shares of common stock per $1,000 principal amount. The effective conversion rate is $8.06 per share of common stock, subject to adjustment under customary anti-dilutive provisions. They also are redeemable should EMCORE's common stock price reach $12.09 per share. As a result of this transaction, EMCORE recognized a non-cash loss of approximately $1.1 million in the first quarter of fiscal 2006. EMCORE will also incur an additional non-cash loss of approximately $1.1 million over the life of the subordinated notes issued to Alexandra, which will be charged as interest expense. Furthermore, the 2006 Notes exchanged by Alexandra represented approximately 91.4% of the $15,775,000 total amount of existing 2006 Notes outstanding at the time of the transaction. EMCORE paid the remaining $1,350,000 of 2006 Notes on the May 15, 2006 maturity date.

NOTE 13. Commitments and Contingencies.

EMCORE is involved in lawsuits and proceedings that arise in the ordinary course of business. There are no matters pending that we expect to be material in relation to our business, consolidated financial condition, results of operations, or cash flows.

EMCORE guarantees 49% of any amounts borrowed under GELcore’s revolving credit line. As of June 30, 2006, GELcore’s outstanding borrowings were $4.9 million. The maximum borrowing currently permitted under the credit line is approximately $10.0 million.

NOTE 14. Segment Data and Related Information.

EMCORE has three operating segments: Fiber Optics, Photovoltaics, and Electronic Materials and Devices:

· EMCORE's Fiber Optics revenues are derived primarily from sales of optical components and subsystems for cable television (CATV), fiber to the premise (FTTP), enterprise routers and switches, telecom grooming switches, core routers, high performance servers, supercomputers, and satellite communications data links.

· EMCORE's Photovoltaics revenues are derived primarily from the sales of solar power conversion products, including solar cells, covered interconnect solar cells, and solar panels.

· EMCORE's Electronic Materials and Devices revenues are derived primarily from sales of wireless components, such as radio frequency (RF) materials including hetero-junction bipolar transistors and enhancement-mode pseudomorphic high electron mobility transistors, GaN materials for wireless base stations, and process development technology.

EMCORE evaluates its reportable segments in accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information.* EMCORE’s Chief Executive Officer is EMCORE’s Chief Operating Decision Maker pursuant to SFAS 131, and he allocates resources to segments based on their business prospects, competitive factors, net revenue, operating results and other non-GAAP financial ratios.

The following tables set forth the revenues and percentage of total revenues attributable to each of EMCORE's operating segments for the three and nine months ended June 30, 2006 and 2005.

Revenues by Segment *(in thousands)*	**Three months ended June 30, 2006**			**Three months ended June 30, 2005**		
		Revenue	**% of Revenue**		**Revenue**	**% of Revenue**
Fiber Optics	$	25,968	61.9%	$	21,109	63.5%
Photovoltaics		10,354	24.7		8,807	26.5
Electronic Materials and Devices		5,632	13.4		3,318	10.0
Total revenues	$	41,954	100.0%	$	33,234	100.0%

Revenues by Segment *(in thousands)*	**Nine months ended June 30, 2006**			**Nine months ended June 30, 2005**		
		Revenue	**% of Revenue**		**Revenue**	**% of Revenue**
Fiber Optics	$	76,825	62.5%	$	57,828	63.8%
Photovoltaics		31,342	25.5		24,084	26.6
Electronic Materials and Devices		14,840	12.0		8,716	9.6
Total revenues	$	123,007	100.0%	$	90,628	100.0%

The following tables set forth EMCORE's consolidated revenues by geographic region. Revenue was assigned to geographic regions based on the customers' or contract manufacturers' shipment locations.

Geographic Revenues *(in thousands)*	**Three months ended June 30, 2006**			**Three months ended June 30, 2005**		
		Revenue	**% of Revenue**		**Revenue**	**% of Revenue**
North America	$	32,201	76.8%	$	28,969	87.2%
South America, Africa and Asia		8,573	20.4		2,893	8.7
Europe		1,180	2.8		1,372	4.1
Total revenues	$	41,954	100.0%	$	33,234	100.0%

Geographic Revenues *(in thousands)*	**Nine months ended June 30, 2006**			**Nine months ended June 30, 2005**		
		Revenue	**% of Revenue**		**Revenue**	**% of Revenue**
North America	$	100,272	81.5%	$	74,681	82.4%
South America, Africa and Asia		19,517	15.9		10,915	12.0
Europe		3,218	2.6		5,032	5.6
Total revenues	$	123,007	100%	$	90,628	100.0%

For the three months ended June 30, 2006, Jabil Circuit, Ltd. (Jabil) accounted for 10% of our total revenue. Jabil acts as a contract manufacturer assembling systems for Cisco. A majority of EMCORE's sales to Jabil consisted of 10G Ethernet module products historically sold to Cisco. For the nine months ended June 30, 2006 and 2005, Cisco accounted for 14% and 21% of our total revenue, respectively. For the three months ended June 30, 2005, Space Systems/Loral accounted for 11% of our total revenue.

The following table sets forth operating losses attributable to each EMCORE operating segment.

Operating Loss by Segment (*in thousands*)	**Three Months Ended June 30,**		**Nine Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Operating (loss) income by segment:				
Fiber Optics	$ (3,733)	$ (2,869)	$ (11,166)	$ (11,387)
Photovoltaics	(1,037)	(1,707)	(4,485)	(2,759)
Electronic Materials and Devices	54	(656)	(1,201)	(3,297)
Operating loss	(4,716)	(5,232)	(16,852)	(17,443)
Other (income) expenses:				
Interest expense	1,068	905	3,149	2,827
Loss from convertible subordinated notes exchange offer	-	-	1,078	-
Equity in net loss of Velox investment	-	-	332	-
Equity in net loss (income) of GELcore investment	129	778	(21)	703
Total other expenses	1,197	1,683	4,538	3,530
Loss from continuing operations	$ (5,913)	$ (6,915)	$ (21,390)	$ (20,973)

On October 1, 2005, EMCORE adopted SFAS No. 123(R) and incurred stock-based compensation expense as more fully described in Note 3 to EMCORE's condensed consolidated financial statements. For the three and nine months ended June 30, 2006, operating loss includes the effect of $1.0 million and $3.1 million, respectively, of stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123(R). There was no stock-based compensation expense in fiscal 2005.

Operating loss also includes a $2.7 million charge associated with a related-party loan forgiveness. This charge was allocated to each segment based upon fiscal 2006 forecasted annual revenues.

Long-lived assets (consisting of property, plant and equipment, goodwill and intangible assets) for each operating segment are as follows:

Long-Lived Assets (*in thousands*)	**As of June 30, 2006**	**As of September 30, 2005**
Fiber Optics	$ 61,309	$ 56,261
Photovoltaics	39,082	37,861
Electronic Materials and Devices	3,705	2,825
Total	$ 104,096	$ 96,947

NOTE 15. Subsequent Event.

On July 19, 2006, EMCORE entered into an Asset Purchase Agreement (the "Purchase Agreement") with IQE plc, a public limited company organized under the laws of the United Kingdom ("IQE"), and IQE RF, LLC, a New Jersey limited liability corporation and a wholly owned subsidiary of IQE (the "Purchaser"). Under the Purchase Agreement, the Purchaser will purchase the assets of EMCORE's Electronic Materials & Device division (the "EMD Business"), including inventory, fixed assets, and intellectual property, for $16.0 million (the "Purchase Price"), consisting of a $0.2 million deposit previously delivered to EMCORE, $12.8 million delivered via wire transfer at closing of the transaction, and $3.0 million in the form of a secured promissory note of IQE and Purchaser (the "Note"), guaranteed by IQE's affiliates. The Note is to be repaid in four quarterly installments beginning in calendar year 2007, and bears interest at 7.5%. The transaction is currently expected to close in mid-August.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934. These forward-looking statements are based largely on our current expectations and projections about future events and financial trends affecting the financial condition of our business. These forward-looking statements may be identified by the use of terms and phrases such as "expects", "anticipates", "intends", "plans", "believes", "estimates", "targets", "can", "may", "could", "will variations of these terms and similar phrases. Management cautions that these forward-looking statements are subject to business, economic, and other risks and uncertainties, both known and unknown, that may cause actual results to be materially different from those discussed in these forward-looking statements. The cautionary statements made in this Report should be read as being applicable to all forward-looking statements wherever they appear in this Report. This discussion should be read in conjunction with the consolidated financial statements, including the related notes.

These forward-looking statements include, without limitation, any and all statements or implications regarding:

· The ability of EMCORE Corporation (EMCORE) to remain competitive and a leader in its industry and the future growth of the company, the industry, and the economy in general;

· Difficulties in integrating recent or future acquisitions into our operations;

· The expected level and timing of benefits to EMCORE from on-going cost reduction efforts, including (i) expected cost reductions and their impact on our financial performance, (ii) our continued leadership in technology and manufacturing in our markets, and (iii) our belief that the cost reduction efforts will not impact product development or manufacturing execution;

· Expected improvements in our product and technology development programs;

· Whether our products will (i) be successfully introduced or marketed, (ii) be qualified and purchased by our customers, or (iii) perform to any particular specifications or performance or reliability standards; and/or

· Guidance provided by EMCORE regarding our expected financial performance in current or future periods, including, without limitation, with respect to anticipated revenues, income, or cash flows for any period in fiscal 2006 and subsequent periods.

These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected, including without limitation, the following:

· EMCORE's cost reduction efforts may not be successful in achieving their expected benefits, or may negatively impact our operations;

· EMCORE may incur increased costs due to difficulties in integrating recent acquisitions;

· The failure of our products (i) to perform as expected without material defects, (ii) to be manufactured at acceptable volumes, yields, and cost, (iii) to be qualified and accepted by our customers, and (iv) to successfully compete with products offered by our competitors; and/or

· Other risks and uncertainties described in EMCORE's filings with the Securities and Exchange Commission (SEC) such as: cancellations, rescheduling, or delays in product shipments; manufacturing capacity constraints; lengthy sales and qualification cycles; difficulties in the production process; changes in semiconductor industry growth; increased competition; delays in developing and commercializing new products; and other factors.

Neither management nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. Forward-looking statements are made only as of the date of this Report and subsequent facts or circumstances may contradict, obviate, undermine, or otherwise fail to support or substantiate such statements. We assume no obligation to update the matters discussed in this Quarterly Report on Form 10-Q to conform such statements to actual results or to changes in our expectations, except as required by applicable law or regulation.

Company Overview

EMCORE, a New Jersey corporation established in 1984, offers a broad portfolio of compound semiconductor-based components and subsystems for the broadband, fiber optic, satellite, solar and wireless communications markets. EMCORE has three operating segments: Fiber Optics, Photovoltaics, and Electronic Materials and Devices. Our integrated solutions philosophy embodies state-of-the-art technology, material science expertise, and a shared vision of our customer's goals and objectives to be leaders in the transport of video, voice and data over copper, hybrid fiber/coax (HFC), fiber, satellite, and wireless networks.

EMCORE’s Fiber Optic segment offers optical components, subsystems and systems for high speed data and telecommunications networks, cable television (CATV) and fiber-to-the-premises (FTTP). EMCORE’s Photovoltaic segment provides products for both satellite and terrestrial applications. For satellite applications, EMCORE offers high efficiency Gallium Arsenide (GaAs) solar cells, Covered Interconnect Cells (CICs) and panels. For terrestrial applications, EMCORE is adapting its high-efficiency GaAs solar cells for use in solar concentrator systems. Our Electronic Materials and Devices segment provides radio frequency (RF) transistor materials for high bandwidth wireless communications systems.

Through its joint venture participation in GELcore, LLC, EMCORE plays a vital role in developing and commercializing next-generation high-brightness LED technology for use in the general and specialty illumination markets.

Management Summary

We are an industry-leading company in the development and manufacture of optoelectronic and high-frequency products. By leveraging our broad compound semiconductor expertise to provide cost-effective components, subsystems, and systems, we are focused on several key markets:

· Terrestrial solar power for industrial power markets;

· High-speed fiber optics for telephony, Internet core and metro networks;

· High-speed fiber optics for large enterprise data communications, super computing, and storage area networks;

· Next-generation CATV and FTTP “triple play” networks;

· Satellite communications, in space and on the ground;

· Advanced transistors and amplifiers used in high-bandwidth wireless communications systems, such as WiMAX and Wi-Fi Internet access and 3G mobile handsets and PDA devices; and

· Solid state lighting for specialty and commercial illumination.

EMCORE has been supplying high-efficiency GaAs solar cells to the satellite industry since 1999. Recently, with the increase in traditional energy costs, we have been involved in migrating our GaAs high-efficiency solar cells for terrestrial applications. EMCORE has developed a 35% high-efficiency terrestrial based solar cell and has fulfilled orders for two solar concentrator companies, and provided samples to several others including two major system manufacturers in Europe and Asia.

Demand for EMCORE's products continue to be driven principally by increased communications bandwidth requirements and by expanded competition between telecommunications carriers, CATV multiple service operators (MSOs), and wireless network providers for the delivery of video, voice and data. We also continue our leadership of the 10G Ethernet space, commenced volume production of a next-generation FTTP triplexer product, won numerous major satellite programs, and increased sales of our 3G wireless and base station materials. In fiscal 2006 to date, revenues have increased by 36% over the prior period. We are continuing our efforts to streamline operations and focus on bottom-line profitability.

We are operationally focused on driving profitable revenue growth based on our existing product lines, developing or acquiring next-generation technologies and high-margin products for our strategic markets, and continuing our business optimization efforts to manage costs and enhance productivity. While targeting 20-30% annual top-line growth, we intend to continue to improve annual gross margins through material cost reductions, overseas contract manufacturing labor, yield improvements and product design improvements.

Subsequent Event

On July 19, 2006, EMCORE entered into an Asset Purchase Agreement (the "Purchase Agreement") with IQE plc, a public limited company organized under the laws of the United Kingdom ("IQE"), and IQE RF, LLC, a New Jersey limited liability corporation and a wholly owned subsidiary of IQE (the "Purchaser"). Under the Purchase Agreement, the Purchaser will purchase the assets of EMCORE's Electronic Materials & Device division (the "EMD Business"), including inventory, fixed assets, and intellectual property, for $16.0 million (the "Purchase Price"), consisting of a $0.2 million deposit previously delivered to EMCORE, $12.8 million delivered via wire transfer at closing of the transaction, and $3.0 million in the form of a secured promissory note of IQE and Purchaser (the "Note"), guaranteed by IQE's affiliates. The Note is to be repaid in four quarterly installments beginning in calendar year 2007, and bears interest at 7.5%. IQE will continue to operate the EMD Business in the Somerset, New Jersey facility, and approximately 50 employees of EMCORE will be transferred to IQE. The transaction is currently expected to close in mid-August.

Business Segments, Geographic Revenues and Customers

EMCORE has three operating segments: Fiber Optics, Photovoltaics, and Electronic Materials and Devices:

· EMCORE's Fiber Optics revenues are derived primarily from sales of optical components and subsystems for CATV, FTTP, enterprise routers and switches, telecom grooming switches, core routers, high performance servers, supercomputers and satellite communications data links.

· EMCORE's Photovoltaics revenues are derived primarily from the sales of solar power conversion products, including solar cells, covered interconnect solar cells, and solar panels.

· EMCORE's Electronic Materials and Devices revenues are derived primarily from sales of wireless components, such as RF materials including hetero-junction bipolar transistors and enhancement-mode pseudomorphic high electron mobility transistors, BiFET power amplifiers for 3G, GSM, and high bandwidth wireless communications, GaN materials for wireless base stations and high frequency applications, and process development technology.

The following tables set forth the revenues and percentage of total revenues attributable to each of EMCORE's operating segments for the three and nine months ended June 30, 2006 and 2005.

Revenues by Segment	**Three months ended**	**Three months ended**

(in thousands)	June 30, 2006			June 30, 2005		
		Revenue	% of Revenue		Revenue	% of Revenue
Fiber Optics	$	25,968	61.9%	$	21,109	63.5%
Photovoltaics		10,354	24.7		8,807	26.5
Electronic Materials and Devices		5,632	13.4		3,318	10.0
Total revenues	$	41,954	100.0%	$	33,234	100.0%

Revenues by Segment *(in thousands)*	Nine months ended June 30, 2006			Nine months ended June 30, 2005		
		Revenue	% of Revenue		Revenue	% of Revenue
Fiber Optics	$	76,825	62.5%	$	57,828	63.8%
Photovoltaics		31,342	25.5		24,084	26.6
Electronic Materials and Devices		14,840	12.0		8,716	9.6
Total revenues	$	123,007	100.0%	$	90,628	100.0%

The following tables set forth EMCORE's consolidated revenues by geographic region. Revenue was assigned to geographic regions based on the customers' or contract manufacturers' shipment locations.

Geographic Revenues *(in thousands)*	Three months ended June 30, 2006			Three months ended June 30, 2005		
		Revenue	% of Revenue		Revenue	% of Revenue
North America	$	32,201	76.8%	$	28,969	87.2%
South America, Africa and Asia		8,573	20.4		2,893	8.7
Europe		1,180	2.8		1,372	4.1
Total revenues	$	41,954	100.0%	$	33,234	100.0%

Geographic Revenues *(in thousands)*	Nine months ended June 30, 2006			Nine months ended June 30, 2005		
		Revenue	% of Revenue		Revenue	% of Revenue
North America	$	100,272	81.5%	$	74,681	82.4%
South America, Africa and Asia		19,517	15.9		10,915	12.0
Europe		3,218	2.6		5,032	5.6
Total revenues	$	123,007	100.0%	$	90,628	100.0%

EMCORE is devoted to working directly with its customers from initial product design, product qualification and manufacturing to product delivery. EMCORE's customer base includes many of the largest semiconductor, telecommunications, data communications, and computer manufacturing companies in the world. For the three months ended June 30, 2006, Jabil Circuit, Ltd. accounted for 10% of our total revenue. Jabil acts as a contract manufacturer assembling systems for Cisco. A majority of EMCORE's sales to Jabil consisted of 10G Ethernet module products historically sold to Cisco. For the nine months ended June 30, 2006 and 2005, Cisco accounted for 14% and 21% of our total revenue, respectively. For the three months ended June 30, 2005, Space Systems/Loral accounted for 11% of our total revenue.

The following table sets forth operating losses attributable to each EMCORE operating segment

Operating Loss by Segment (*in thousands*)	**Three Months Ended June 30,**		**Nine Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Operating (loss) income by segment:				
Fiber Optics	$ (3,733)	$ (2,869)	$ (11,166)	$ (11,387)
Photovoltaics	(1,037)	(1,707)	(4,485)	(2,759)
Electronic Materials and Devices	54	(656)	(1,201)	(3,297)
Operating loss	(4,716)	(5,232)	(16,852)	(17,443)
Other (income) expenses:				
Interest expense	1,068	905	3,149	2,827
Loss from convertible subordinated notes exchange offer	-	-		