

AXT INC  
Form 10-Q  
August 09, 2010  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**for the quarterly period ended June 30, 2010**

**Or**

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**for the transition period from                      to**

**Commission File Number 000-24085**

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# AXT, INC.

(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State or other jurisdiction of  
Incorporation or organization)

**94-3031310**  
(I.R.S. Employer  
Identification No.)

**4281 Technology Drive, Fremont, California 94538**

(Address of principal executive offices) (Zip code)

**(510) 683-5900**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its 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 <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input checked="" type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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.

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**Class**  
Common Stock, \$0.001 par value

**Outstanding at July 23, 2010**  
31,024,198

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

AXT, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	June 30, 2010 (unaudited)	December 31, 2009 (1)
Assets:		
Current assets:		
Cash and cash equivalents	\$ 20,394	\$ 16,934
Short-term investments	11,321	18,469
Accounts receivable, net of allowances of \$797 and \$1,019 as of June 30, 2010 and December 31, 2009, respectively	18,640	15,362
Inventories, net	27,247	27,718
Prepaid expenses and other current assets	4,032	2,411
Total current assets	81,634	80,894
Long-term investments	7,210	
Property, plant and equipment, net	20,314	20,853
Other assets	6,199	6,199
Total assets	\$ 115,357	\$ 107,946
Liabilities and stockholders' equity:		
Current liabilities:		
Accounts payable	\$ 4,008	\$ 5,571
Accrued liabilities	5,424	4,566
Current portion of long-term debt	77	76
Total current liabilities	9,509	10,213
Long-term debt, net of current portion	381	420
Other long-term liabilities	3	62
Total liabilities	9,893	10,695
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 2,000 shares authorized; 883 shares issued and outstanding as of June 30, 2010 and December 31, 2009, respectively (Liquidation preference of \$5.5 million and \$5.4 million as of June 30, 2010 and December 31, 2009, respectively)	3,532	3,532
Common stock, \$0.001 par value per share; 70,000 shares authorized; 31,024 and 30,880 shares issued and outstanding as of June 30, 2010 and December 31, 2009, respectively	30	30
Additional paid-in capital	188,270	187,871
Accumulated deficit	(93,015)	(101,130)
Accumulated other comprehensive income	3,644	4,300
Total AXT, Inc. stockholders' equity	102,461	94,603

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Noncontrolling interests	3,003	2,648
Total stockholders' equity	105,464	97,251
Total liabilities and stockholders' equity	\$ 115,357	\$ 107,946

See accompanying notes to condensed consolidated financial statements.

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(1) The Condensed Consolidated Balance Sheet at December 31, 2009 has been derived from the audited consolidated financial statements at that date.

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AXT, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenue	\$ 23,177	\$ 13,055	\$ 41,818	\$ 20,709
Cost of revenue	14,642	10,539	26,551	18,430
Gross profit	8,535	2,516	15,267	2,279
Operating expenses:				
Selling, general and administrative	3,039	3,486	6,458	7,492
Research and development	515	355	966	815
Restructuring charge				507
Total operating expenses	3,554	3,841	7,424	8,814
Income (loss) from operations	4,981	(1,325)	7,843	(6,535)
Interest income (expense), net	(25)	34	(10)	78
Other income (expense), net	1,556	321	1,635	(101)
Income (loss) before provision for income taxes	6,512	(970)	9,468	(6,558)
Provision for income taxes	(560)	(308)	(806)	(312)
Net income (loss)	5,952	(1,278)	8,662	(6,870)
Less: Net income (loss) attributable to noncontrolling interest	(417)	(2)	(547)	74
Net income (loss) attributable to AXT, Inc.	\$ 5,535	\$ (1,280)	\$ 8,115	\$ (6,796)
Net income (loss) attributable to AXT, Inc. per common share:				
Basic	\$ 0.18	\$ (0.04)	\$ 0.26	\$ (0.23)
Diluted	\$ 0.17	\$ (0.04)	\$ 0.25	\$ (0.23)
Weighted average number of common shares outstanding:				
Basic	30,834	30,439	30,789	30,437
Diluted	32,172	30,439	31,982	30,437

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Six Months Ended June 30,	
	2010	2009
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 8,662	\$ (6,870)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	1,411	1,570
Amortization (accretion) of marketable securities premium	47	(6)
Loss (gain) on disposal of property, plant and equipment	1	4
Stock-based compensation	233	579
Restructuring charge		507
Realized loss (gain) on available for sale securities	(196)	9
Changes in assets and liabilities:		
Accounts receivable, net	(3,306)	(1,386)
Inventories	350	6,766
Prepaid expenses and other current assets	(1,657)	1,394
Other assets	(22)	(101)
Accounts payable	(1,523)	(2,302)
Accrued liabilities	869	(385)
Other long-term liabilities	(12)	(983)
Net cash provided by (used in) operating activities	4,857	(1,204)
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment	(1,187)	(390)
Proceeds from sale of property, plant and equipment	4	
Purchases of available for sale securities	(11,202)	(13)
Proceeds from available for sale securities	10,996	440
Decrease in restricted deposits		13
Net cash provided by (used in) investing activities	(1,389)	50
<b>Cash flows from financing activities:</b>		
Proceeds from common stock options exercised	166	40
Dividends paid	(192)	
Long-term debt payments	(38)	(49)
Net cash used in financing activities	(64)	(9)
Effect of exchange rate changes on cash and cash equivalents	52	10
Net increase (decrease) in cash and cash equivalents	3,460	(1,153)
Cash and cash equivalents at the beginning of the period	16,934	13,566
Cash and cash equivalents at the end of the period	\$ 20,394	\$ 12,413

See accompanying notes to condensed consolidated financial statements.





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AXT, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Note 1. Basis of Presentation**

The accompanying condensed consolidated financial statements of AXT, Inc. ( AXT, the Company, we, us, and our refer to AXT, Inc. and its consolidated subsidiaries) are unaudited, and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the year-end condensed consolidated balance sheet data was derived from our audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of our management, the unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, considered necessary to present fairly the financial position, results of operations and cash flows of AXT and our consolidated subsidiaries for all periods presented.

Our management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ materially from those estimates.

The results of operations are not necessarily indicative of the results to be expected in the future or for the full fiscal year. It is recommended that these condensed consolidated financial statements be read in conjunction with our consolidated financial statements and the notes thereto included in our 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC ) on March 22, 2010 and our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 filed with the SEC on May 17, 2010.

Certain reclassifications have been made to the prior period consolidated financial statements to conform to current period presentation. These reclassifications had no impact on previously reported total assets, stockholders' equity or net income (loss).

**Note 2. Accounting for Stock-Based Compensation**

We account for stock-based compensation in accordance with the provisions of FASB Accounting Standards Codification ( ASC ) topic 718, *Compensation-Stock Compensation* ( ASC 718 ), which established accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at each grant date, based on the fair value of the award, and is recognized as expense over the employee's requisite service period of the award. All of the Company's stock compensation is accounted for as an equity instrument. The provisions of ASC 718 apply to all awards granted or modified after the date of adoption which was January 1, 2006. The unrecognized expense of awards not yet vested at the date of adoption will be recognized in net income (loss) in the periods after the date of adoption using the same Black-Scholes valuation method and assumptions determined under the original provisions of ASC 718.

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We utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted both before and after the adoption of ASC 718. The following table summarizes compensation costs related to our stock-based compensation awards (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Stock-based compensation in the form of employee stock options, included in:				
Cost of revenue	\$ 5	\$ 10	\$ 15	\$ 23
Selling, general and administrative	103	93	200	511
Research and development	11	18	18	45
Total stock-based compensation	119	121	233	579
Tax effect on stock-based compensation				
Net effect on net income (loss)	\$ 119	\$ 121	\$ 233	\$ 579
Effect on net income (loss) attributable to AXT, Inc. per common share:				
Basic	\$ 0.00	\$ 0.00	\$ 0.01	\$ 0.02
Diluted	\$ 0.00	\$ 0.00	\$ 0.01	\$ 0.02

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As of June 30, 2010 the total compensation costs related to unvested stock-based awards granted to employees under our stock option plan but not yet recognized was approximately \$830,000, net of estimated forfeitures of \$200,000. These costs will be amortized on a straight-line basis over a weighted-average period of approximately 2.98 years and will be adjusted for subsequent changes in estimated forfeitures. We elected not to capitalize any stock-based compensation to inventory as of June 30, 2010 due to the immateriality of the amount.

The amortization of stock compensation under ASC 718 for the period after our January 1, 2006 adoption is based on the single-option approach.

We estimate the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of ASC 718. There were no stock option grants made in the three and six months ended June 30, 2010 and 2009.

The following table summarizes the stock option transactions during the six months ended June 30, 2010 (in thousands, except per share data):

	Shares	Weighted-average Exercise Price	Weighted-average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Options outstanding as of January 1, 2010	2,880	\$ 2.46		
<b>Granted</b>				
Exercised	(117)	1.43		
Canceled and expired	(15)	19.99		
Options outstanding as of June 30, 2010	2,748	\$ 2.41	5.27	\$ 6,657
Options vested and expected to vest as of June 30, 2010	2,659	\$ 2.43	5.14	\$ 6,425
Options exercisable as of June 30, 2010	1,819	\$ 2.60	3.35	\$ 4,298

As of December 31, 2009, options to purchase 1,900,000 shares at a weighted average exercise price of \$2.64 per share were vested and exercisable.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing price of \$4.51 on June 30, 2010, which would have been received by the option holder had all option holders exercised their options on that date. The total number of in-the-money options exercisable as of June 30, 2010 was 1,212,000.

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The options outstanding and exercisable as of June 30, 2010 were in the following exercise price ranges:

Options Outstanding as of June 30, 2010				Options Exercisable as of June 30, 2010	
Range of Exercise Price	Shares	Weighted-average Exercise Price	Weighted-average Remaining Contractual Life	Shares	Weighted-Average Exercise Price
\$1.17 - \$1.18	318,200	\$ 1.17	2.15	318,200	\$ 1.17
\$1.25 - \$1.34	257,842	\$ 1.32	4.56	257,842	\$ 1.32
\$1.38 - \$1.38	305,400	\$ 1.38	3.19	305,400	\$ 1.38
\$1.40 - \$1.40	1,094	\$ 1.40	4.70	1,094	\$ 1.40
\$1.59 - \$1.59	565,621	\$ 1.59	7.33	171,185	\$ 1.59
\$1.88 - \$1.98	17,000	\$ 1.93	4.64	17,000	\$ 1.93
\$2.04 - \$2.04	488,700	\$ 2.04	9.32	0	\$ 0
\$2.19 - \$2.19	312,250	\$ 2.19	2.40	312,250	\$ 2.19
\$3.11 - \$6.31	438,317	\$ 4.90	4.65	392,191	\$ 4.78
\$9.69 - \$39.80	44,000	\$ 16.75	1.63	44,000	\$ 16.75
	2,748,424	\$ 2.41	5.27	1,819,162	\$ 2.60

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There were 26,497 and 116,658 options exercised in the three months and six months ended June 30, 2010, respectively. The total intrinsic value of options exercised for the three and six months ended June 30, 2010 was \$102,106 and \$266,674, respectively. Cash received from options exercised for the three and six months ended June 30, 2010 was \$34,200 and \$166,200, respectively. There were no options exercised in the three and six months ended June 30, 2009.

***Restricted stock awards***

A summary of activity related to restricted stock awards for the six months ended June 30, 2010 is presented below:

	Shares		Weighted-Average Grant Date Fair Value
Non-vested restricted stock shares outstanding as of January 1, 2010	170,660	\$	1.21
Restricted stock shares granted	27,027	\$	3.33
Restricted stock shares vested	(43,839)	\$	1.11
Non-vested restricted stock shares outstanding as of June 30, 2010	153,848	\$	1.61

As of June 30, 2010, we had \$194,000 of unrecognized compensation expense, net of forfeitures, related to restricted stock awards, which will be recognized over the weighted average period of 1.35 years. During the six months ended June 30, 2010 and 2009, 43,839 shares and 3,532 shares of restricted stock vested respectively.

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Our cash, cash equivalents and investments, and strategic investments in privately-held companies are classified as follows (in thousands):

	June 30, 2010			December 31, 2009				
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value
<b>Classified as:</b>								
Cash	\$ 20,339	\$	\$	\$ 20,339	\$ 16,790	\$	\$	\$ 16,790
Cash equivalents:								
Money market fund	55			55	144			144
Total cash and cash equivalents								
	20,394			20,394	16,934			16,934
Investments:								
Certificates of Deposit	4,560	3	(3)	4,560				
US Treasury and agency securities	4,969	2	(3)	4,968				
Corporate bonds	9,124		(121)	9,003	18,298	171		18,469
Total investments	18,653	5	(127)	18,531	18,298	171		18,469
Total cash, cash equivalents and investments								
	\$ 39,047	\$ 5	\$ (127)	\$ 38,925	\$ 35,232	\$ 171	\$	\$ 35,403
<b>Contractual maturities on investments:</b>								
Due within 1 year	\$ 11,411			\$ 11,321	\$ 18,298			\$ 18,469
Due after 1 through 5 years	7,242			7,210				
	\$ 18,653			\$ 18,531	\$ 18,298			\$ 18,469

We manage our investments as a single portfolio of highly marketable securities that is intended to be available to meet our current cash requirements. We have no investments in auction rate securities. For the three and six months ended June 30, 2010 we had \$76,000 and \$196,000 gross realized gains on sales of our available-for-sale securities, respectively. For the three and six months ended June 30, 2009 we had \$9,000 gross realized losses on sales of our available-for-sale securities.

The gross unrealized losses related to our portfolio of available-for-sale securities were primarily due to a decrease in the fair value of debt securities. We have determined that the gross unrealized losses on our available-for-sale securities as of June 30, 2010 are temporary in nature. We reviewed our investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is temporary include the magnitude of the decline in market value, the length of time the market value has been below cost (or adjusted cost), credit quality, and our ability and intent to hold the securities for a period of time sufficient to allow for any anticipated recovery in market value. The following table provides a breakdown of our available-for-sale securities with unrealized losses as of June 30, 2010 (in thousands):

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	In Loss Position < 12 months		In Loss Position > 12 months		Total In Loss Position	
	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)
Investments:						
Certificates of Deposit	\$ 3,117	\$ (3)	\$	\$	\$ 3,117	\$ (3)
US Treasury and agency securities	2,534	(3)			2,534	(3)
Corporate bonds	1,586	(35)	7,417	(83)	9,003	(118)
Total in loss position	\$ 7,237	\$ (41)	\$ 7,417	\$ (83)	\$ 14,654	\$ (124)



Table of Contents***Investments in Privately-held Companies***

We have made strategic investments in private companies located in China in order to gain access at a competitive cost to raw materials that are critical to our substrate business (see Note 9). The investment balances for the two companies accounted for under the equity method are included in other assets in the condensed consolidated balance sheets and totaled \$4.3 million and \$4.2 million as of June 30, 2010 and December 31, 2009, respectively. We have investments in three unconsolidated privately-held companies accounted for under the cost method. As of June 30, 2010 and December 31, 2009, our investments in the three unconsolidated privately-held companies accounted for under the cost method had a carrying value of \$0.7 million and \$0.7 million, respectively, and are included in other assets in the condensed consolidated balance sheets.

***Fair Value Measurements***

On January 1, 2008, we adopted ASC topic 820, *Fair Value Measurements and Disclosures* ( ASC 820 ) which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. ASC 820 applies whenever other statements require or permit assets or liabilities to be measured at fair value. ASC 820 applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis and requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. Certain financial assets and liabilities that are not required to be recorded at fair value, including accounts receivable, accounts payable, accrued liabilities and term debt, have recorded values that approximate fair value given their short term nature and relative terms of the agreement.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 as of June 30, 2010 (in thousands):

	<b>Balance as of June 30, 2010</b>	<b>Quoted Prices in Active Markets of Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>
<b>Assets:</b>			
Cash equivalents and investments:			
Money market fund - cash	\$ 55	\$ 55	\$
Certificates of deposit	\$ 4,560		4,560
US Treasury and agency securities	\$ 4,968		4,968
Corporate bonds	9,003		9,003
<b>Total</b>	<b>\$ 18,586</b>	<b>\$ 55</b>	<b>\$ 18,531</b>
<b>Liabilities</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>

Our financial assets and liabilities are valued using market prices on both active markets (Level 1) and less active markets (Level 2). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations are obtained from readily-available pricing sources for comparable instruments. As of June 30, 2010, we did not have any assets or liabilities without observable market values that would require a high level of judgment to determine fair value (Level 3 assets).

*Items Measured at Fair Value on a Nonrecurring Basis*

Certain assets that are subject to nonrecurring fair value measurements are not included in the table above. These assets include equity and cost method investments in private companies. We did not record other-than-temporary impairment charges for either of these investments during the first six months of 2010 or 2009.

**Note 4. Inventories, Net**

The components of inventories are summarized below (in thousands):

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Inventories, net:		
Raw materials	\$ 11,387	\$ 12,051
Work in process	12,129	11,947
Finished goods	3,731	3,720
	<b>\$ 27,247</b>	<b>\$ 27,718</b>

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In March 2009, we reduced the workforce at our Fremont and Beijing facilities by approximately 11 positions that were no longer required to support certain production and administrative operations. This measure was being taken as part of our 2009 operating plan. Accordingly, we recorded a restructuring charge of \$507,000 in March 2009 related to the reduction in force for severance-related expenses from the reduction in force, all of which were paid during the second quarter of 2009. We expect to save approximately \$1.3 million annually in payroll and related expenses. We had no restructuring charge in the first six months of 2010.

**Note 6. Net Income (Loss) Per Share**

Basic net income (loss) per common share is calculated by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common and common equivalent shares include the dilutive effect of common stock equivalents outstanding during the period calculated using the treasury stock method. Common stock equivalents consist of the shares issuable upon the exercise of stock options.

A reconciliation of the numerators and denominators of the basic and diluted net income (loss) per share calculations is as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Numerator:</b>				
Net income (loss) attributable to AXT, Inc.	\$ 5,535	\$ (1,280)	\$ 8,115	\$ (6,796)
Less: Preferred stock dividends	(44)	(44)	(88)	(88)
Net income (loss) available to common stockholders	\$ 5,491	\$ (1,324)	\$ 8,027	\$ (6,884)
<b>Denominator:</b>				
Denominator for basic net income (loss) per share - weighted average common shares	30,834	30,439	30,789	30,437
<b>Effect of dilutive securities:</b>				
Common stock options	1,338		1,193	
Denominator for diluted net income (loss) per common share	32,172	30,439	31,982	30,437
<b>Effect on net income (loss) attributable to AXT, Inc. per common share:</b>				
Basic	\$ 0.18	\$ (0.04)	\$ 0.26	\$ (0.23)
Diluted	\$ 0.17	\$ (0.04)	\$ 0.25	\$ (0.23)
Options excluded from diluted per share calculation as the impact is anti-dilutive	351	2,615	355	2,615

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The 883,000 shares of \$0.001 par value Series A preferred stock issued on May 28, 1999 are non-voting and non-convertible preferred stock with a 5.0% cumulative annual dividend rate payable when declared by the board of directors, and a \$4 per share liquidation preference over common stock, and must be paid before any distribution is made to common stockholders.

Table of Contents**Note 7. Stockholders Equity and Other Comprehensive Income (Loss)****Consolidated Statements of Changes in Equity**

	Preferred Stock	Common Stock	Additional Paid In Capital	Accumulated Deficit	Other Comprehensive Income/(loss)	AXT, Inc. stockholders equity	Noncontrolling interests	Total stockholders equity
Balance as of December 31, 2009	\$ 3,532	\$ 30	\$ 187,871	\$ (101,130)	\$ 4,300	\$ 94,603	\$ 2,648	\$ 97,251
Common stock options exercised			166			166		166
Stock-based compensation			233			233		233
Comprehensive income:								
Net income				8,115		8,115	547	8,662
Dividend paid							(192)	(192)
Change in unrealized (loss) gain on marketable securities					(293)	(293)		(293)
Currency translation adjustment					(363)	(363)		(363)
Balance as of June 30, 2010	\$ 3,532	\$ 30	\$ 188,270	\$ (93,015)	\$ 3,644	\$ 102,461	\$ 3,003	\$ 105,464

The components of comprehensive income (loss) are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income (loss) attributable to AXT, Inc.	\$ 5,535	\$ (1,280)	\$ 8,115	\$ (6,796)
Other comprehensive income (loss), net of tax:				
Change in foreign currency translation gain (loss), net of tax	(158)	(42)	(363)	(40)
Change in unrealized gain (loss) on available-for-sale investments, net of tax	(274)	703	(293)	890
Total other comprehensive income (loss), net of tax	(432)	661	(656)	850
Comprehensive income (loss)	5,103	(619)	7,459	(5,946)
Comprehensive income (loss) attributable to the noncontrolling interest		1		2
Comprehensive income (loss) attributable to AXT, Inc.	\$ 5,103	\$ (618)	\$ 7,459	\$ (5,944)

**Note 8. Segment Information and Foreign Operations****Segment Information**

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We operate in one segment for the design, development, manufacture and distribution of high-performance compound semiconductor substrates and sale of materials. In accordance with ASC topic 280, *Segment Reporting*, our chief operating decision-maker has been identified as the principal executive officer, who reviews operating results to make decisions about allocating resources and assessing performance for the Company. Since we operate in one segment, all financial segment and product line information can be found in the consolidated financial statements.

### *Product Information*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenue by product type:				
GaAs substrates	\$ 16,235	\$ 10,108	\$ 29,669	\$ 15,120
InP substrates	1,077	684	1,952	1,174
Ge substrates	1,602	1,217	3,242	1,839
Raw materials and other	4,263	1,046	6,955	2,576
Total	\$ 23,177	\$ 13,055	\$ 41,818	\$ 20,709

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The following table represents revenue amounts (in thousands) reported for products shipped to customers in the corresponding geographic region:

	Three Months Ended June 30,		Six Months Ended June 30	
	2010	2009	2010	2009
Revenue by geographic region:				
North America*	\$ 4,717	\$ 2,428	\$ 9,248	\$ 4,164
Europe	4,201	2,264	7,969	4,477
Japan	3,504	2,038	6,282	3,190
Taiwan	4,019	2,746	6,601	3,435
Asia Pacific	6,736	3,579	11,718	5,443
Total	\$ 23,177	\$ 13,055	\$ 41,818	\$ 20,709

\*Primarily the United States

Long-lived assets consist primarily of property, plant and equipment, and are attributed to the geographic location in which they are located. Long-lived assets by geographic region were as follows (in thousands):

	As of	
	June 30, 2010	December 31, 2009
Long-lived assets by geographic region:		
North America	\$ 610	\$ 661
China	19,704	20,192
	\$ 20,314	\$ 20,853

**Significant Customers**

One customer represented more than 10% of revenue at 18.7% for the three month period ended June 30, 2010 while two customers each represented more than 10% of revenue at 16.0% and 11.6% for the three month period ended June 30, 2009. One customer represented more than 10% of revenue at 17.6% for the six month period ended June 30, 2010 while two customers represented more than 10% at 15.3% and 11.5% revenues for the six month period ended June 30, 2009. Our top five customers represented 42.5% and 43.4% of revenue for the three month periods ended June 30, 2010 and 2009, respectively. Our top five customers represented 40.5% and 40.3% of revenue for the six month periods ended June 30, 2010 and 2009, respectively.

We perform periodic credit evaluations of our customers financial condition and generally do not require collateral. Two customers each accounted for 10% or more of our trade accounts receivable balance as of June 30, 2010 at 30%, and 11%, respectively.

**Note 9. Investments in Privately-held Companies**

We have made strategic investments in private companies located in China in order to gain access to raw materials at a competitive cost that are critical to our substrate business.

Our investments are summarized below (in thousands):

Company	Investment Balance as of		Accounting Method	Ownership Percentage
	June 30, 2010	December 31, 2009		
Beijing JiYa Semiconductor Material Co., Ltd	\$ 996	\$ 996	Consolidated	46%
Nanjing Jin Mei Gallium Co., Ltd	592	592	Consolidated	83%
Beijing BoYu Semiconductor Vessel Craftwork Technology Co., Ltd	410	410	Consolidated	70%
	\$ 1,998	\$ 1,998		
Xilingol Tongli Germanium Co. Ltd	\$ 3,355	\$ 3,367	Equity	25%
Emeishan Jia Mei High Purity Metals Co., Ltd	959	866	Equity	25%
	\$ 4,314	\$ 4,233		



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Our ownership of Beijing Ji Ya Semiconductor Material Co., Ltd. (JiYa) is 46%. We continue to consolidate JiYa as we have significant influence in management and have a majority control of the board. Our chief executive officer is chairman of the JiYa board, while our president of China operations and our vice president of China administration and our vice president of wafer production are also members of the JiYa board.

Our ownership of Nanjing Jin Mei Gallium Co., Ltd. (Jin Mei) is 83%. We continue to consolidate Jin Mei as we have significant influence in management and have a majority control of the board. Our chief executive officer is chairman of the Jin Mei board, while our president of China operations and our vice president of China administration are also members of the Jin Mei board.

Our ownership of Beijing BoYu Semiconductor Vessel Craftwork Technology Co., Ltd (BoYu), is 70%. We continue to consolidate Bo Yu as we have a significant influence over management and have a majority control of the board. Our chief executive officer is chairman of the BoYu board and our president of China operations and our vice president of China administration are members of the BoYu board.

Although we have representation on the boards of directors of each of these companies, the daily operations of each of these companies are managed by local management and not by us. Decisions concerning their respective short term strategy and operations, any capacity expansion and annual capital expenditures, and decisions concerning sales of finished product, are made by local management with some input from us.

The investment balances for the two companies accounted for under the equity method are included in other assets in the consolidated balance sheets and totaled \$4.3 million and \$4.2 million as of June 30, 2010 and December 31, 2009, respectively. We own 25% of the ownership interests in each of these companies. These two companies are not considered variable interest entities because:

- both companies have sustainable businesses of their own;
- our voting power is proportionate to our ownership interests;
- we only recognize our respective share of the losses and/or residual returns generated by the companies if they occur; and
- we do not have controlling financial interest in, do not maintain operational or management control of, do not control the board of directors of, and are not required to provide additional investment or financial support to either company.

During the three and six months ended June 30, 2010 the three consolidated joint ventures had income of \$1.3 million and \$1.8 million of which \$0.4 million and \$0.5 million, respectively, was allocated to minority interests, resulting in income of \$0.9 million and \$1.3 million, respectively, included in our net income. During the three and six months ended June 30, 2009 the three consolidated joint ventures had \$83,000 of income and a loss of \$167,000 of which \$2,000 and a loss of \$74,000 was allocated to minority interests, resulting in income of \$81,000 and a

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loss of \$93,000 included in our net loss. Our equity earnings from the two-minority owned joint ventures that are not consolidated are recorded as other income (loss), net and totaled \$82,000 and \$139,000 for the six months ended June 30, 2010 and 2009, respectively. Undistributed retained earnings relating to all our investments in these companies were \$13.8 million and \$12.4 million as of June 30, 2010 and December 31, 2009, respectively.

Our two minority-owned joint ventures that are not consolidated and accounted for under the equity method had the following summarized income information (in thousands) for the three and six months ended June 30, 2010 and 2009, respectively.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net Sales	\$ 3,504	\$ 4,111	\$ 6,842	\$ 6,215
Gross profit	895	1,164	1,790	1,851
Operating income	277	675	400	748
Net income	244	526	326	555

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We have investments in three unconsolidated privately-held companies accounted for under the cost method. As of June 30, 2010 and December 31, 2009, our investments in the three unconsolidated privately-held companies accounted for under the cost method had a carrying value of \$0.7 million and \$0.7 million, respectively, and are included in other assets in the condensed consolidated balance sheets.

**Note 10. Commitments and Contingencies***Indemnification Agreements*

We enter into standard indemnification arrangements in the ordinary course of business. Pursuant to these arrangements, we indemnify, hold harmless, and agree to reimburse the indemnified parties for losses suffered or incurred by the indemnified party, generally our business partners or customers, in connection with any U.S. patent, or any copyright or other intellectual property infringement claim by any third party with respect to our products. The term of these indemnification agreements is generally perpetual anytime after the execution of the agreement. The maximum potential amount of future payments we could be required to make under these agreements is unlimited. We have never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, we believe the estimated fair value of these agreements is minimal.

We have entered into indemnification agreements with our directors and officers that may require us to indemnify our directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct of a culpable nature; to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified; and to obtain directors and officers insurance if available on reasonable terms, which we currently have in place.

*Product Warranty*

We warrant our products for a specific period of time, generally twelve months, against material defects. We provide for the estimated future costs of warranty obligations in cost of sales when the related revenue is recognized. The accrued warranty costs represent the best estimate at the time of sale of the total costs that we expect to incur to repair or replace product parts that fail while still under warranty. The amount of accrued estimated warranty costs are primarily based on historical experience as to product failures as well as current information on repair costs. On a quarterly basis, we review the accrued balances and update these based on the historical warranty cost trends. The following table reflects the change in our warranty accrual which is included in accrued liabilities on the condensed consolidated balance sheets during the three and six months ended June 30, 2010 and 2009 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,		
	2010	2009	2010	2009	
Beginning accrued warranty and related costs	\$ 1,086	\$ 1,463	\$ 1,082	\$ 1,640	
Charged to cost of revenue	(206)	242	(146)	318	
Actual warranty expenditures		(210)	(56)	(463)	

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Ending accrued warranty and related costs	\$	880	\$	1,495	\$	880	\$	1,495
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### *Purchase Obligations*

Through the normal course of business, we purchase or place orders for the necessary materials of our products from various suppliers and we commit to purchase products where we may incur a penalty if the agreement was canceled. As of June 30, 2010, we did not have any outstanding material purchase obligations.

### **Legal Proceedings**

From time to time we may be involved in judicial or administrative proceedings concerning matters arising in the ordinary course of business. We do not expect that any of these matters, individually or in the aggregate, will have a material adverse effect on our business, financial condition, cash flows or results of operation.

### **Note 11. Foreign Exchange Transaction Gains/Losses**

We incurred foreign currency transaction exchange gains of \$230,000 and \$183,000 for the three month periods ended June 30, 2010, and 2009, respectively. We incurred foreign currency transaction exchange gains of \$162,000 and foreign exchange losses of \$253,000 for the six month periods ended June 30, 2010, and 2009, respectively. These amounts are included in Other income (expense), net on the condensed consolidated statements of operations.

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**Note 12. Income Taxes**

In July 2006, the Financial Accounting Standards Board ( FASB ) issued ASC topic 740, *Income Taxes* ( ASC 740 ). ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with ASC 740. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted ASC 740 effective January 1, 2007. We recognize interest and penalties related to uncertain tax positions in income tax expense. As of June 30, 2010, we did not have any gross unrecognized tax benefits, nor any accrued interest and penalties related to uncertain tax positions. As a result of the implementation of ASC 740, we identified \$16.4 million in the liability for unrecognized tax benefits. Of this amount, none was accounted for as a reduction to the January 1, 2007 balance of retained earnings. The amount decreased the tax loss carryforwards in the U.S. which are fully offset by a valuation allowance. We file income tax returns in the U.S. federal, various states and foreign jurisdictions. We have substantially concluded all U.S. federal and state income tax matters through December 31, 2008. There were no Federal U.S. tax expense during three and six months ended June 30, 2010 due to the valuation allowance being utilized.

**Note 13. Recent Accounting Pronouncements**

With the exception of those stated below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended June 30, 2010, as compared to the recent accounting pronouncements described in the Annual Report that are of material significance, or have potential material significance, to the Company.

In May 2009, the FASB issued guidance contained in FASB ASC 855, *Subsequent Events* to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance was effective for interim or annual financial periods ending after June 15, 2009. In February, 2010, the FASB issued Accounting Standards Update 2010-09 *Subsequent Events* which removed the requirement to disclose the date through which subsequent events had been considered for disclosure. This update was effective upon issuance. In accordance with this guidance, we have evaluated and, as necessary, made changes to these unaudited Condensed Consolidated Financial Statements for the events.

In October 2009, the FASB issued ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements a Consensus of the FASB Emerging Issues Task Force* an update to Accounting Standards Codification (ASC) Topic 605, *Revenue Recognition*. This update requires the allocation of consideration among separately identified deliverables contained within an arrangement, based on their related selling prices. This update will be effective for annual reporting periods beginning January 1, 2011. The Company is currently evaluating the impact of this update on its financial position, results of operations, cash flows, and disclosures.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements* an update to ASC Topic 820, *Fair Value Measurements and Disclosures*. This update requires an entity to: (i) disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers and (ii) present separate information for Level 3 activity pertaining to gross purchases, sales, issuances, and settlements. This update became effective for us in the quarter ended March 31, 2010, except that the disclosure on the roll forward activities for Level 3 fair value measurements will become effective for us with the reporting period beginning January 1, 2011. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the Company's financial statements.



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

This quarterly report on Form 10-Q, including the following sections, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, particularly statements relating to our expectations regarding results of operations, customer demand, our ability to leverage our manufacturing capabilities and access to favorably priced raw materials to increase our market share, industry trends, our ability to expand our markets and increase sales, gross margins, our reserve balances, our expected savings from our workforce reduction, the impact of the adoption of certain accounting pronouncements, our investments in capital projects, our belief that we have adequate cash and investments to meet our needs over the next 12 months, and our expectation that our exposure to Citigroup will decrease as our principal protected notes comes due and the underlying assets are placed into diversified securities. These forward-looking statements are based upon management's current views with respect to future events and financial performance, and are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or those anticipated in such forward-looking statements. Such risks and uncertainties include those set forth under the section entitled "Risk Factors" below, which identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in this Form 10-Q and other filings we have made with the Securities and Exchange Commission. Forward-looking statements may be identified by the use of terms such as "anticipates," "believes," "estimates," "expects," "intends," and similar expressions. Statements concerning our future or expected financial results and condition, business strategy and plans or objectives for future operations are forward-looking statements.

These forward-looking statements are not guarantees of future performance. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. This discussion should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2009 and the condensed consolidated financial statements included elsewhere in this report.

**Overview**

We are a leading worldwide developer and producer of high-performance compound and single element semiconductor substrates comprising gallium arsenide (GaAs), indium phosphide (InP) and germanium (Ge). We currently sell the following substrate products in the sizes and for the applications indicated:

Substrates	Product	Diameter	Applications
GaAs (semi-insulating)		2 , 3 , 4 , 5 , 6	<ul style="list-style-type: none"> <li>• Power amplifiers and radio frequency integrated circuits for wireless handsets (cell phones)</li> <li>• Direct broadcast television</li> <li>• High-performance transistors</li> <li>• Satellite communications</li> </ul>
GaAs (semi-conducting)		2 , 3 , 4	<ul style="list-style-type: none"> <li>• High brightness light emitting diodes</li> <li>• Lasers</li> <li>• Optical couplers</li> </ul>
InP		2 , 3 , 4	<ul style="list-style-type: none"> <li>• Broadband and fiber optic communications</li> </ul>
Ge		2 , 4	<ul style="list-style-type: none"> <li>• Satellite and terrestrial solar cells</li> </ul>

We manufacture all of our semiconductor substrates using our proprietary vertical gradient freeze (VGF) technology. Most of our revenue is from sales of GaAs substrates. We manufacture all of our products in the People's Republic of China (PRC or China), which generally has favorable costs for facilities and labor compared to comparable facilities in the United States or Europe. We also have three majority-owned and two minority-owned joint ventures in China which provide us favorable pricing, reliable supply and enhanced sourcing lead-times for key raw materials which are central to our final manufactured products. These joint ventures produce products including 99.99% pure gallium (4N Ga), high purity gallium, arsenic, germanium, germanium dioxide, paralytic boron nitride (pBN) crucibles and boron oxide. AXT's ownership interest in these entities ranges from 25% to 83%. We consolidate the three ventures in which we own a majority or controlling financial interest and employ equity accounting for the two joint ventures in which we have a 25% interest. We purchase portions of the materials produced by these ventures for our own use and the joint ventures sell the remainder of their production to third parties. We use our direct sales force in the United States and independent sales



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representatives in Europe and Asia to market our substrates. We believe that, as the demand for compound semiconductor substrates is expected to increase, we are positioned to leverage our PRC-based manufacturing capabilities and access to favorably priced raw materials to increase our market share.

While the volatile business and financial markets are prompting us to continue to take a conservative approach to our business, we remain optimistic about our business. Positive industry trends in the first half of 2010, coupled with our competitive manufacturing and cost advantages give us confidence in our ability to continue to drive future business in 2010. Following very challenging industry conditions in the first half of 2009, we began to see stronger sales and improved gross margins in the second half of 2009. Our qualification efforts in both gallium arsenide and germanium substrates have been successful and we are pleased with our increasing diversification in these areas.

As of June 30, 2010, our principal sources of liquidity were \$38.9 million in cash and cash equivalents and short and long-term investments. This increased by \$3.5 million compared to cash and cash equivalents and short-term investments of \$35.4 million at December 31, 2009.

**Critical Accounting Policies and Estimates**

We have prepared our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. As such, we have had to make estimates, assumptions and judgments that affect the amounts reported on our financial statements. These estimates, assumptions and judgments about future events and their effects on our results cannot be determined with certainty, and are made based upon our historical experience and on other assumptions that are believed to be reasonable under the circumstances. These estimates may change as new events occur or additional information is obtained, and we may periodically be faced with uncertainties, the outcomes of which are not within our control and may not be known for a prolonged period of time. The discussion and analysis of our results of operations and financial condition are based upon these condensed consolidated financial statements.

We have identified the policies below as critical to our business operations and understanding of our financial condition and results of operations.

A critical accounting policy is one that is both material to the presentation of our financial statements and requires us to make difficult, subjective or complex judgments that could have a material effect on our financial condition and results of operations. They may require us to make assumptions about matters that are highly uncertain at the time of the estimate, and different estimates that we could have used, or changes in the estimate that are reasonably likely to occur, may have a material impact on our financial condition or results of operations. We believe that the following are our critical accounting policies:

***Revenue Recognition***

We manufacture and sell high-performance compound semiconductor substrates and sell certain raw materials including gallium, germanium dioxide, and pBN crucibles. After we ship our products, there are no remaining obligations or customer acceptance requirements that would preclude revenue recognition. Our products are typically sold pursuant to a purchase order placed by our customers, and our terms and

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conditions of sale do not require customer acceptance. We recognize revenue upon shipment and transfer of title of products to our customers, which is either upon shipment from our dock, receipt at the customer's dock, or removal from consignment inventory at the customer's location, provided that we have received a signed purchase order, the price is fixed or determinable, title and risk of ownership have transferred, collection of resulting receivables is probable, and product returns are reasonably estimable. We do not provide training, installation or commissioning services. We may provide discounts or other incentives to customers in order to secure business.

We provide for future returns based on historical experience, current economic trends and changes in customer demand at the time revenue is recognized.

### *Accounts Receivable and Allowance for Doubtful Accounts*

We periodically review the likelihood of collection on our accounts receivable balances and provide an allowance for doubtful accounts receivable primarily based upon the age of these accounts. We provide a 100% allowance for receivables from U.S. customers in excess of 90 days and for receivables from customers located outside the U.S. in excess of 120 days. We assess the probability of collection based on a number of factors, including the length of time a receivable balance has been outstanding, our past history with the customer and their creditworthiness.

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As of June 30, 2010 and December 31, 2009, our accounts receivable, net, balance was \$18.6 million and \$15.4 million, respectively, which was net of an allowance for doubtful accounts of \$0.1 million and \$0.2 million, respectively. If actual uncollectible accounts differ substantially from our estimates, revisions to the estimated allowance for doubtful accounts would be required, which could have a material impact on our financial results for the period.

The allowance for sales returns is also deducted from gross accounts receivable. As of June 30, 2010 and December 31, 2009, our allowance for sales returns was \$0.7 million and \$0.8 million, respectively.

***Warranty Reserve***

We maintain a warranty reserve based upon our claims experience during the prior twelve months. Warranty costs are accrued at the time revenue is recognized. As of June 30, 2010 and December 31, 2009, accrued product warranties totaled \$0.9 million and \$1.1 million, respectively. If actual warranty costs differ substantially from our estimates, revisions to the estimated warranty liability would be required, which could have a material impact on our financial condition and results of operations.

***Inventory Valuation***

Inventories are stated at the lower of cost or market. Cost is determined using the weighted average cost method. Our inventory consists of raw materials as well as finished goods and work-in-process that include material, labor and manufacturing overhead costs. Given the nature of our substrate products, and the materials used in the manufacturing process, the wafers and ingots comprising work-in-process may be held in inventory for up to two years and three years, respectively, as the risk of obsolescence for these materials is low. We routinely evaluate the levels of our inventory in light of current market conditions in order to identify excess and obsolete inventory, and we provide a valuation allowance for certain inventories based upon the age and quality of the product and the projections for sale of the completed products. As of June 30, 2010 and December 31, 2009, we had an inventory reserve of \$9.7 million and \$10.1 million, respectively, for excess and obsolete inventory. The majority of this inventory has not been scrapped, and accordingly, may be sold in future periods. If actual demand for our products were to be substantially lower than estimated, additional inventory adjustments for excess or obsolete inventory might be required, which could have a material impact on our business, financial condition and results of operations.

***Impairment of Investments***

We classify our investments in debt and equity securities as available-for-sale securities as prescribed by ASC topic 320, *Debt and Equity Securities*. All available-for-sale securities with a quoted market value below cost (or adjusted cost) are reviewed in order to determine whether the decline is other-than-temporary. Factors considered in determining whether a loss is temporary include the magnitude of the decline in market value, the length of time the market value has been below cost (or adjusted cost), credit quality, and our ability and intent to hold the securities for a period of time sufficient to allow for any anticipated recovery in market value.

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In addition to our five joint ventures, we have in the past invested in equity instruments of privately-held companies for business and strategic purposes. These investments are classified as other assets and are accounted for under the cost method as we do not have the ability to exercise significant influence over their operations. We monitor our investments for impairment and record reductions in carrying value when events or changes in circumstances indicate that the carrying value may not be recoverable. Determination of impairment is highly subjective and is based on a number of factors, including an assessment of the strength of investee's management, the length of time and extent to which the fair value has been less than our cost basis, the financial condition and near-term prospects of the investee, fundamental changes to the business prospects of the investee, share prices of subsequent offerings, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in our carrying value.

### *Fair Value of Investments*

In the current market environment, the assessment of the fair value of debt instruments can be difficult and subjective. The volume of trading activity of certain debt instruments has declined, and the rapid changes occurring in today's financial markets can lead to changes in the fair value of financial instruments in relatively short periods of time. ASC 820 establishes three levels of inputs that may be used to measure fair value.

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Level 1 instruments represent quoted prices in active markets. Therefore, determining fair value for Level 1 instruments does not require significant management judgment, and the estimation is not difficult. Level 2 instruments include observable inputs other than Level 1 prices, such as quoted prices for identical instruments in markets with insufficient volume or infrequent transactions (less active markets), issuer credit ratings, non-binding market consensus prices that can be corroborated with observable market data, model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities, or quoted prices for similar assets or liabilities. These Level 2 instruments require more management judgment and subjectivity compared to Level 1 instruments, including:

- Determining which instruments are most similar to the instrument being priced requires management to identify a sample of similar securities based on the coupon rates, maturity, issuer, credit rating, and instrument type, and subjectively select an individual security or multiple securities that are deemed most similar to the security being priced.
- Determining whether a market is considered active requires management judgment. Our assessment of an active market for our marketable debt instruments generally takes into consideration activity during each week of the one-month period prior to the valuation date of each individual instrument, including the number of days each individual instrument trades and the average weekly trading volume in relation to the total outstanding amount of the issued instrument.
- Determining which model-derived valuations to use in determining fair value requires management judgment. When observable market prices for identical securities or similar securities are not available, we price our marketable debt instruments using non-binding market consensus prices that are corroborated with observable market data or pricing models, such as discounted cash flow models, with all significant inputs derived from or corroborated with observable market data.

Level 3 instruments include unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities. The determination of fair value for Level 3 instruments requires the most management judgment and subjectivity. As of June 30, 2010, we did not have any assets or liabilities without observable market values that would require a high level of judgment to determine fair value (Level 3 assets).

***Impairment of Long-Lived Assets***

We evaluate the recoverability of property, equipment and intangible assets in accordance with ASC topic 360, *Impairment of Disposal of Long-Lived Assets*. When events and circumstances indicate that long-lived assets may be impaired, we compare the carrying value of the long-lived assets to the projection of future undiscounted cash flows attributable to these assets. In the event that the carrying value exceeds the future undiscounted cash flows, we record an impairment charge against income equal to the excess of the carrying value over the assets' fair value. Fair values are determined based on quoted market values, discounted cash flows or internal and external appraisals, as applicable. Assets held for sale are carried at the lower of carrying value or estimated net realizable value.

***Employee Stock Options***

We grant options to substantially all management employees and believe that this program helps us to attract, motivate and retain high quality employees, to the ultimate benefit of our stockholders. Effective January 1, 2006, we adopted the fair value recognition provisions of ASC 718, using the modified prospective application transition method. Under this transition method, stock-based compensation cost was recognized in the condensed consolidated financial statements for all share-based payments after January 1, 2006. Compensation cost recognized includes the estimated expense for the portion of the vesting period after January 1, 2006 for share-based payments prior to, but not vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of ASC 718. We recognize these compensation costs net of an estimated forfeiture rate over the requisite service period of the award, which is generally the vesting term of four years for stock options. Results for prior periods have not been restated, as provided for under the modified prospective application transition method.

### *Income Taxes*

We account for income taxes in accordance with ASC 740 which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized.

We provide for income taxes based upon the geographic composition of worldwide earnings and tax regulations governing each region, particularly China. The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws, particularly in foreign countries such as China.

Effective January 1, 2007, we adopted ASC 740. See Note 12 *Income Taxes* in the notes to condensed financial statements for additional information.

Table of Contents**Results of Operations****Revenue**

	<b>Three Months Ended June 30,</b>			<b>Increase (Decrease)</b>	<b>% Change</b>
	<b>2010</b>	<b>2009</b>			
		(\$ in thousands)			
GaAs	\$ 16,235	\$ 10,108	\$ 6,127	60.6%	
InP	1,077	684	393	57.5%	
Ge	1,602	1,217	385	31.6%	
Raw materials and other	4,263	1,046	3,217	307.6%	
Total revenue	\$ 23,177	\$ 13,055	\$ 10,122	77.5%	

Revenue increased \$10.1 million, or 77.5%, to \$23.2 million for the three months ended June 30, 2010 from \$13.1 million for the three months ended June 30, 2009. Total GaAs substrate revenue increased \$6.1 million, or 60.6%, to \$16.2 million for the three months ended June 30, 2010 from \$10.1 million for the three months ended June 30, 2009. The increase in revenue was primarily due to the improved demand environment positively affecting sales of all diameters.

Sales of 5 inch and 6 inch diameter GaAs substrates were \$6.8 million for the three months ended June 30, 2010 compared to \$4.4 million for the three months ended June 30, 2009. The increased demand for large diameter substrates was fueled by strong sales of wireless devices.

Sales of 2 inch, 3 inch and 4 inch diameter GaAs substrates were \$9.4 million for the three months ended June 30, 2010 compared with \$5.7 million for the three months ended June 30, 2009. Similar to the increase in revenue from larger diameter substrates, the increase in revenue from smaller diameter substrates was due to strong sales of wireless devices as well as the increasing worldwide adoption and investment in LED technology in many applications.

InP substrate revenue increased \$0.4 million, or 57.5%, to \$1.1 million for the three months ended June 30, 2010 from \$0.7 million for the three months ended June 30, 2009 as demand from customers in the optical networking industry increased. We continue to see renewed demand for these substrates as investment in high-speed optical communications is increasing worldwide.

Ge substrate revenue increased \$0.4 million, or 31.6%, to \$1.6 million for the three months ended June 30, 2010 from \$1.2 million for the three months ended June 30, 2009. Our Ge substrate revenue increased as demand from our customers increases for concentrated photovoltaic solar applications. We continue to make progress in our penetration of the solar cell market, particularly in satellite applications.

Raw materials revenue increased \$3.2 million, or 307.6%, to \$4.3 million for the three months ended June 30, 2010 from \$1.0 million for the three months ended June 30, 2009. Raw materials revenue was low in the prior year primarily due to the worldwide drop in demand for 4N gallium. We have seen an increase in the demand for 4N gallium in 2010 as the market recovers from the worldwide downturn of 2009.

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	Six Months Ended June 30,			
	2010	2009	Increase (Decrease)	% Change
	(\$ in thousands)			
GaAs	\$ 29,669	\$ 15,120	\$ 14,549	96.2%
InP	1,952	1,174	778	66.3%
Ge	3,242	1,839	1,403	76.3%
Raw materials and other	6,955	2,576	4,379	170.0%
Total revenue	\$ 41,818	\$ 20,709	\$ 21,109	101.9%

Revenue increased \$21.1 million, or 101.9%, to \$41.8 million for the six months ended June 30, 2010 from \$20.7 million for the six months ended June 30, 2009. Total GaAs substrate revenue increased \$14.5 million, or 96.2%, to \$29.7 million for the six months ended June 30, 2010 from \$15.1 million for the six months ended June 30, 2009. The increase in revenue was primarily due to the improved demand environment positively affecting sales of all diameters.



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Sales of 5 inch and 6 inch diameter GaAs substrates were \$12.3 million for the six months ended June 30, 2010 compared to \$5.6 million for the six months ended June 30, 2009. The increased demand for large diameter substrates was fueled by strong sales of wireless devices.

Sales of 2 inch, 3 inch and 4 inch diameter GaAs substrates were \$17.4 million for the six months ended June 30, 2010 compared with \$9.5 million for the six months ended June 30, 2009. Similar to the increase in revenue from larger diameter substrates, the increase in revenue from smaller diameter substrates was due to strong sales of wireless devices as well as the increasing worldwide adoption and investment in LED technology in many applications.

InP substrate revenue increased \$0.8 million, or 66.3%, to \$2.0 million for the six months ended June 30, 2010 from \$1.2 million for the six months ended June 30, 2009 as demand from customers in the optical networking industry increased. We continue to see renewed demand for these substrates as investment in high-speed optical communications is increasing worldwide.

Ge substrate revenue increased \$1.4 million, or 76.3%, to \$3.2 million for the six months ended June 30, 2010 from \$1.8 million for the six months ended June 30, 2009. Our Ge substrate revenue increased as demand from our customers increase for concentrated photovoltaic solar applications. We continue to make progress in our penetration of the solar cell market, particularly in satellite applications.

Raw materials revenue increased \$4.4 million, or 170.0%, to \$7.0 million for the six months ended June 30, 2010 from \$2.6 million for the six months ended June 30, 2009. Raw materials revenue was low in the prior year primarily due to the worldwide drop in demand for 4N gallium. We have seen an increase in the demand for 4N gallium in 2010 as the market recovers from the worldwide downturn of 2009.

**Revenue by Geographic Region**

	Three Months Ended June 30,		Increase (Decrease)	% Change
	2010	2009		
	(\$ in thousands)			
North America *	\$ 4,717	\$ 2,428	\$ 2,289	94.3%
<i>% of total revenue</i>	20.4%	18.6%		
Europe	4,201	2,264	1,937	85.6%
<i>% of total revenue</i>	18.1%	17.4%		
Japan	3,504	2,038	1,466	71.9%
<i>% of total revenue</i>	15.1%	15.6%		
Taiwan	4,019	2,746	1,273	46.4%
<i>% of total revenue</i>	17.3%	21.0%		
Asia Pacific (excluding Japan and Taiwan)	6,736	3,579	3,157	88.2%
<i>% of total revenue</i>	29.1%	27.4%		
Total revenue	\$ 23,177	\$ 13,055	\$ 10,122	77.5%

\*Primarily the United States

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Revenue from customers in North America increased by \$2.3 million, or 94.3%, to \$4.7 million for the three months ended June 30, 2010 from \$2.4 million for the three months ended June 30, 2009 as the demand for substrates increased by \$1.9 million and the demand for raw materials increased by \$0.4 million due to the stronger demand environment compared to the economic slowdown we experienced in the prior year.

Revenue from customers in Europe increased by \$1.9 million, or 85.6%, to \$4.2 million for the three months ended June 30, 2010 from \$2.3 million for the three months ended June 30, 2009. This increase came primarily from increased substrate sales of \$1.1 million to customers in Germany due to increased demand, as well as \$0.8 million increased raw material sales to customers in Slovakia as the demand for 4N gallium increased.

Revenue from customers in Japan increased by \$1.5 million, or 71.9%, to \$3.5 million for the three months ended June 30, 2010 from \$2.0 million for the three months ended June 30, 2009. Substrate sales increased by \$0.8 million, particularly in large diameter wafers, and raw material sales of 4N gallium increased by \$0.7 million as demand increased.

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Revenue from customers in Taiwan increased by \$1.3 million, or 46.4%, to \$4.0 million for the three months ended June 30, 2010 from \$2.7 million for the three months ended June 30, 2009. The increase came mainly from demand for both semi-insulating and semi-conducting substrates.

Revenue from customers in Asia Pacific (excluding Japan and Taiwan) increased by \$3.2 million, or 88.2%, to \$6.7 million for the three months ended June 30, 2010 from \$3.6 million for the three months ended June 30, 2009. Sales to customers in Singapore increased by \$1.6 million, as demand for large diameter wafers increased, while sales to customers in China increased by \$1.4 million, primarily from sales and of raw materials.

	2010	Six Months Ended June 30, 2009	Increase (Decrease)	% Change
	(\$ in thousands)			
North America *	\$ 9,248	\$ 4,164	\$ 5,084	122.1%
<i>% of total revenue</i>	22.1%	20.1%		
Europe	7,969	4,477	3,492	78.0%
<i>% of total revenue</i>	19.1%	21.6%		
Japan	6,282	3,190	3,092	96.9%
<i>% of total revenue</i>	15.0%	15.4%		
Taiwan	6,601	3,435	3,166	92.2%
<i>% of total revenue</i>	15.8%	16.6%		
Asia Pacific (excluding Japan and Taiwan)	11,718	5,443	6,275	115.3%
<i>% of total revenue</i>	28.0%	26.3%		
Total revenue	\$ 41,818	\$ 20,709	\$ 21,109	101.9%

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\*Primarily the United States

Revenue from customers in North America increased by \$5.1 million, or 122.1%, to \$9.2 million for the six months ended June 30, 2010 from \$4.2 million for the six months ended June 30, 2009 as the demand for substrates increased by \$4.1 million and the demand for raw materials increased by \$1.0 million due to the stronger demand environment compared to the economic slowdown we experienced in the prior year.

Revenue from customers in Europe increased by \$3.5 million, or 78.0%, to \$8.0 million for the six months ended June 30, 2010 from \$4.5 million for the six months ended June 30, 2009. This increase came primarily from increased substrate sales of \$2.2 million to customers in Germany and \$0.6 million to customers in France, due to increased demand, as well as \$1.1 million increased raw material sales to customers in Slovakia as the demand for 4N gallium increased, partially offset by \$0.4 million decrease in raw material sales to customers in the United Kingdom.

Revenue from customers in Japan increased by \$3.1 million, or 96.9%, to \$6.3 million for the six months ended June 30, 2010 from \$3.2 million for the six months ended June 30, 2009. Substrate sales increased by \$2.0 million, particularly in large diameter wafers, and raw material sales of 4N gallium increased by \$1.1 million as demand increased.

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Revenue from customers in Taiwan increased by \$3.2 million, or 92.2%, to \$6.6 million for the three months ended June 30, 2010 from \$3.4 million for the six months ended June 30, 2009. The increase came mainly from demand for both semi-insulating and semi-conducting substrates.

Revenue from customers in Asia Pacific (excluding Japan and Taiwan) increased by \$6.3 million, or 115.3%, to \$11.7 million for the six months ended June 30, 2010 from \$5.4 million for the six months ended June 30, 2009. Sales to customers in Singapore increased by \$3.1 million, as demand for large diameter wafers increased, while sales to customers in China increased by \$2.9 million, primarily from substrate sales, and sales to Korea increased by \$0.3 million as demand increased.

Table of Contents**Gross Margin**

	Three Months Ended June 30,		Increase (Decrease)	% Change
	2010	2009		
	(\$ in thousands)			
Gross profit	\$ 8,535	\$ 2,516	\$ 6,019	239.2%
Gross Margin %	36.8%	19.3%		

Gross margin increased to 36.8% of total revenue for the three months ended June 30, 2010 from 19.3% of total revenue for the three months ended June 30, 2009. Sales product mix, and process improvements in production such as longer ingots and first pass yield improvements in ingots contributed to higher gross profit for the three months ended June 30, 2010. During the three months ended June 30, 2010, our manufacturing facility in Beijing was operating at a higher utilization capacity compared to the same period in the prior year, which resulted in higher absorption rates. The lower 19.3% gross margin for the three months ended June 30, 2009 was primarily due to the low absorption rates as a result of reduced sales and hence lower production volume.

	Six Months Ended June 30,		Increase (Decrease)	% Change
	2010	2009		
	(\$ in thousands)			
Gross profit	\$ 15,267	\$ 2,279	\$ 12,988	569.9%
Gross Margin %	36.5%	11.0%		

Gross margin increased to 36.5% of total revenue for the six months ended June 30, 2010 from 11.0% of total revenue for the six months ended June 30, 2009. Sales product mix, and process improvements in production such as longer ingots and first pass yield improvements in ingots contributed to higher gross profit for the six months ended June 30, 2010. During the six months ended June 30, 2010, our manufacturing facility in Beijing was operating at a higher utilization capacity compared to the same period in the prior year, which resulted in higher absorption rates. The lower 11.0% gross margin for the six months ended June 30, 2009 was primarily due to the low absorption rates as a result of reduced sales and hence lower production volume.

**Selling, General and Administrative Expenses**

	Three Months Ended June 30,		Increase (Decrease)	% Change
	2010	2009		
	(\$ in thousands)			
Selling, general and administrative expenses	\$ 3,039	\$ 3,486	\$ (447)	(12.8)%
% of total revenue	13.1%	26.7%		

Selling, general and administrative expenses decreased \$0.4 million, or 12.8%, to \$3.0 million for the three months ended June 30, 2010 from \$3.5 million for the three months ended June 30, 2009. The \$0.4 million decrease was from \$0.1 million reduced legal fees, since in the same period in the prior year we had higher legal fees as a result of matters relating to the change in management in March 2009, in addition to \$0.2 million lower labor costs since in the prior year we had severance pay for our former chief operating officer, \$0.3 million in lower bad debt

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expense since in the same period in the prior year we had higher bad debt expense on slower accounts receivables. This was partially offset by a \$0.2 million increase in commissions and sales expenses based on increased sales.

	Six Months Ended June 30,			Increase (Decrease)	% Change
	2010	2009			
	(\$ in thousands)				
Selling, general and administrative expenses	\$ 6,458	\$ 7,492	\$ (1,034)	(13.8)%	
<i>% of total revenue</i>	15.4%	36.2%			

Selling, general and administrative expenses decreased \$1.0 million, or 13.8%, to \$6.5 million for the six months ended June 30, 2010 from \$7.5 million for the six months ended June 30, 2009. The \$1.0 million decrease was from \$0.7 million reduced legal fees, since in the prior year we had higher legal fees as a result of matters relating to the change in management in March 2009, in addition to \$0.3 million in severance pay for our former chief executive officer, \$0.2 million in related stock compensation expense for his stock option acceleration, and \$0.2 million in severance pay for our former chief operating officer. This was partially offset by a \$0.2 million increase in bad debt expense, since in the prior year first quarter we had a large recovery from an account we had provided for at the 2008 year end, and from a \$0.2 million increase in sales commissions based on increased sales.

Table of Contents**Research and Development**

	Three Months Ended June 30,		2009	Increase (Decrease)	% Change		
	2010	(\$ in thousands)					
Research and development	\$	515	\$	355	\$	160	45.1%
<i>% of total revenue</i>		2.2%		2.7%			

Research and development expenses increased \$0.2 million, or 45.1%, to \$0.5 million for the three months ended June 30, 2010 from \$0.4 million for the three months ended June 30, 2009. The increase was primarily due to \$0.1 million increased labor costs from engineers hired and \$0.1 million new products testing costs as we develop and improve our products.

	Six Months Ended June 30,		2009	Increase (Decrease)	% Change		
	2010	(\$ in thousands)					
Research and development	\$	966	\$	815	\$	151	18.5%
<i>% of total revenue</i>		2.3%		3.9%			

Research and development expenses increased \$0.2 million, or 18.5%, to \$1.0 million for the six months ended June 30, 2010 from \$0.8 million for the six months ended June 30, 2009. The increase was primarily due to \$0.1 million increased labor costs from engineers hired and \$0.1 million new products testing costs as we develop and improve our products.

**Restructuring Charge**

	Six Months Ended June 30,		2009	Increase (Decrease)	% Change		
	2010	(\$ in thousands)					
Restructuring charge	\$		\$	507	\$	(507)	NM
<i>% of total revenue</i>		0.0%		2.4%			

NM = % not meaningful

During the first quarter of 2009, we further reduced the workforce at our Fremont and Beijing facilities by approximately 11 positions that were no longer required to support certain production and administrative operations. This measure was taken as part of our 2009 operating plan. Accordingly, we recorded a restructuring charge of \$507,000 in March 2009 related to the reduction in force for severance-related expenses from the reduction in force, all of which were paid in the second quarter of 2009. We expect to save approximately \$1.3 million annually in payroll and related expenses. We had no restructuring charge for the first six months of 2010.

*Interest Income (expense), net*

	Three Months Ended June 30,				
	2010	2009		Increase (Decrease)	% Change
	(\$ in thousands)				
Interest income (expense), net	\$ (25)	\$ 34	\$	(59)	(173.5)%
<i>% of total revenue</i>	0.1%	0.3%			

Interest income (expense), net decreased \$59,000 to \$25,000 expense, net, for the three months ended June 30, 2010 from \$34,000 interest income, net for the three months ended June 30, 2009. Interest income, net for the three months ended June 30, 2010 was lower compared to the three months ended June 30, 2009 which had higher interest income due to higher accrued interest on principal protected notes.

	Six Months Ended June 30,				
	2010	2009		Increase (Decrease)	% Change
	(\$ in thousands)				
Interest income (expense), net	\$ (10)	\$ 78	\$	(88)	(112.8)%
<i>% of total revenue</i>	0.0%	0.4%			

Interest income (expense), net decreased \$88,000 to \$10,000 expense, net, for the six months ended June 30, 2010 from \$78,000 interest income, net for the six months ended June 30, 2009. Interest income, net for the six months ended June 30, 2010 was lower compared to the six months ended June 30, 2009 which had higher interest income due to higher accrued interest on principal protected notes.



Table of Contents**Other Income (Loss), net**

	Three Months Ended June 30,				
	2010	2009		Increase (Decrease)	% Change
	(\$ in thousands)				
Other income, net	\$ 1,556	\$ 321	\$	1,235	384.7%
% of total revenue	6.7%	2.5%			

Other income, net was \$1.6 million for the three months ended June 30, 2010 primarily due to a \$1.2 million sales tax refund and unrealized foreign exchange gains of \$0.2 million and investment income of \$0.2 million mainly from marketable securities and the two minority-owned joint ventures that are not consolidated. Other income, net was \$321,000 for the three months ended June 30, 2009 primarily due to unrealized foreign exchange gains of \$0.2 million and investment income of \$0.1 million from the two minority-owned joint ventures that are not consolidated.

	Six Months Ended June 30,				
	2010	2009		Increase (Decrease)	% Change
	(\$ in thousands)				
Other income (loss), net	\$ 1,635	\$ (101)	\$	1,736	1,718.8%
% of total revenue	3.9%	(0.5)%			

Other income, net was \$1.6 million for the six months ended June 30, 2010 primarily due to a \$1.2 million sales tax refund and unrealized foreign exchange gains of \$0.2 million and investment income of \$0.1 million from the two minority-owned joint ventures that are not consolidated. Other loss, net was \$0.1 million for the six months ended June 30, 2009 primarily due to unrealized foreign exchange loss of \$0.3 million, offset by investment income of \$0.2 million from the two minority-owned joint ventures that are not consolidated.

**Noncontrolling interest**

	Three Months Ended June 30,				
	2010	2009		Increase (Decrease)	% Change
	(\$ in thousands)				
Noncontrolling interest	\$ (417)	\$ (2)	\$	(415)	(20,750.0)%
% of total revenue	1.8%	0.0%			

Noncontrolling interest increased \$0.4 million to \$0.4 million for the three months ended June 30, 2010 from \$2,000 for the three months ended June 30, 2009 indicating more profitability, and hence higher noncontrolling interest portion, from our China joint venture operations as raw materials sales increased due to a stronger demand environment.

Six Months Ended June 30,	Increase
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	2010	(\$ in thousands)		2009	(Decrease)	% Change
Noncontrolling interest	\$	(547)	\$	74	\$ (621)	(839.2)%
<i>% of total revenue</i>		1.3%		0.4%		

Noncontrolling interest increased \$0.6 million to \$0.5 million for the six months ended June 30, 2010 from \$74,000 contribution for the six months ended June 30, 2009 indicating profitability, and hence higher noncontrolling interest portion, from our China joint venture operations as raw materials have increased due to a stronger demand environment.

Table of Contents***Provision for Income Taxes***

	Three Months Ended June 30,			Increase (Decrease)	% Change
	2010	2009			
	(\$ in thousands)				
Provision for income taxes	\$ 560	\$ 308	\$	252	81.8%
% of total revenue	2.4%	2.4%			

We provided for income taxes of \$0.6 million for our China operations for the three months ended June 30, 2010 compared to \$0.3 million for the three months ended June 30, 2009. The increase in tax provision was primarily due to increased sales and increased net income in the second quarter of 2010 compared to the same period last year. No income taxes have been provided for U.S. operations based upon available net operating loss carryforwards.

	Six Months Ended June 30,			Increase (Decrease)	% Change
	2010	2009			
	(\$ in thousands)				
Provision for income taxes	\$ 806	\$ 312	\$	494	158.3%
% of total revenue	1.9%	1.5%			

We provided for income taxes of \$0.8 million for our China operations for the six months ended June 30, 2010 compared to \$0.3 million for the six months ended June 30, 2009. The increase in tax provision was primarily due to increased sales and increased net income for the first six months of 2010 compared to the same period last year. No income taxes have been provided for U.S. operations based upon available net operating loss carryforwards.

**Liquidity and Capital Resources**

As of June 30, 2010, our principal sources of liquidity were \$38.9 million in cash and cash equivalents and short and long-term investments. We consider cash and cash equivalents and short-term investments as liquid and available for use. Short-term investments are comprised of government bonds and high-grade commercial debt instruments. Approximately \$7.5 million of our short-term investments in corporate bonds (see Note 3 to our condensed consolidated financial statements) are invested in Citigroup guaranteed instruments.

Cash and cash equivalents and investments of \$38.9 million decreased by \$0.4 million in the second quarter of 2010 compared to the first quarter of 2010.

Net cash provided by operating activities of \$4.9 million for the six months ended June 30, 2010 was primarily comprised of our net income of \$8.7 million, adjusted for non-cash items of depreciation of \$1.4 million, stock-based compensation of \$0.2 million, partially offset by a realized gain on sale of investments of \$0.2 million, and offset by a net increase of \$5.3 million in assets and liabilities. The \$5.3 million net increase in assets and liabilities primarily resulted from a \$3.3 million increase in accounts receivable, a \$1.7 million increase in prepaid expenses, a \$1.5

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million decrease in accounts payable, partially offset by a \$0.9 million increase in accrued liabilities, and a \$0.4 million decrease in inventories.

Accounts receivable, net increased by \$3.3 million as of June 30, 2010 compared to December 31, 2009 due to higher sales volume. Our days sales outstanding (DSO) was 73 days as of June 30, 2010 and was 79 days as of December 31, 2009.

Net cash used in operating activities of \$1.2 million for the six months ended June 30, 2009 was primarily comprised of our net loss of \$6.9 million, adjusted for non-cash items of depreciation of \$1.6 million, stock-based compensation of \$0.6 million, and a restructuring charge of \$0.5 million, partially offset by a net decrease of \$3.0 million in assets and liabilities. The \$2.9 million net decrease in assets and liabilities primarily resulted from a \$6.8 million decrease in inventory, a \$1.4 million decrease in prepaid expenses, partially offset by a \$2.3 million decrease in accounts payable, a \$1.4 million increase in accounts receivable, a \$1.0 million decrease in other long-term liabilities, a \$0.4 million decrease in accrued liabilities, and a \$0.1 million increase in other assets.

Net cash used in investing activities of \$1.4 million for the six months ended June 30, 2010 was primarily from the purchase of property, plant and equipment of \$1.2 million and by the purchase of investments totaling \$11.2 million offset by the sale of investments totaling \$11.0 million

Net cash provided by investing activities of \$0.1 million for the six months ended June 30, 2009 was primarily from the proceeds on sale of marketable securities of \$0.5 million, partially offset by the purchase of property, plant and equipment of \$0.4 million.

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We expect to invest up to approximately \$7.7 million in capital projects at our China facilities for the remainder of 2010, having delayed certain expansion activities as a result of the impact of the 2009 worldwide economic conditions.

Net cash used in financing activities of \$0.1 million for the six months ended June 30, 2010 consisted of dividends and long term debt payments of \$0.3 million, partially offset by net proceeds of \$0.2 million on the issuance of common stock pursuant to stock option exercises.

Net cash used in financing activities of \$9,000 for the six months ended June 30, 2009 consisted of long term debt payments of \$49,000, partially offset by net proceeds of \$40,000 on the issuance of common stock pursuant to stock option exercises.

We believe that we have adequate cash and investments to meet our needs over the next 12 months. If our sales decrease, however, our ability to generate cash from operations will be adversely affected which could adversely affect our future liquidity, require us to use cash at a more rapid rate than expected, and require us to seek additional capital. There can be no assurance that such additional capital will be available or, if available it will be at terms acceptable to us. Cash from operations could be affected by various risks and uncertainties, including, but not limited to those set forth below under Item 1A Risks Factors.

Outstanding contractual obligations as of June 30, 2010 are summarized as follows (in thousands):

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Tenant improvement loan	\$ 458	\$ 77	\$ 164	\$ 178	\$ 39
Operating leases	1,586	297	559	600	130
Total	\$ 2,044	\$ 374	\$ 723	\$ 778	\$ 169

We lease certain office space, manufacturing facilities and property under long-term operating leases expiring at various dates through November 2013. On July 2, 2008, we entered into a new lease agreement with the landlord of the facility at 4281 Technology Drive, Fremont, California with approximately 27,760 square feet. The new lease commenced December 1, 2008 for a term of seven years, with an option by us to cancel the new lease after five years, upon forfeiture of the security deposit and payment of one-half of the fifth year's rent. Total rent expenses under these operating leases were approximately \$0.2 million and \$0.2 million for the six months ended June 30, 2010 and 2009, respectively.

**Recent Accounting Pronouncements**

With the exception of those stated below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended June 30, 2010, as compared to the recent accounting pronouncements described in the Annual Report that are of material significance, or have potential material significance, to the Company.

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In May 2009, the FASB issued guidance contained in FASB ASC 855, *Subsequent Events* to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance was effective for interim or annual financial periods ending after June 15, 2009. In February, 2010, the FASB issued Accounting Standards Update 2010-09 *Subsequent Events* which removed the requirement to disclose the date through which subsequent events had been considered for disclosure. This update was effective upon issuance. In accordance with this guidance, we have evaluated and, as necessary, made changes to these unaudited Condensed Consolidated Financial Statements for the events.

In October 2009, the FASB issued ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements a Consensus of the FASB Emerging Issues Task Force* an update to Accounting Standards Codification (ASC) Topic 605, *Revenue Recognition*. This update requires the allocation of consideration among separately identified deliverables contained within an arrangement, based on their related selling prices. This update will be effective for annual reporting periods beginning January 1, 2011. The Company is currently evaluating the impact of this update on its financial position, results of operations, cash flows, and disclosures.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements* an update to ASC Topic 820, *Fair Value Measurements and Disclosures*. This update requires an entity to: (i) disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers and (ii) present separate information for Level 3 activity pertaining to gross purchases, sales, issuances, and settlements. This update became effective for us in the quarter ended March 31, 2010, except that the disclosure on the roll forward activities for Level 3 fair value measurements will become effective for us with the reporting period beginning January 1, 2011. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the Company's financial statements.

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In various areas, including revenue recognition, stock option accounting, accounting standards and practices continue to evolve. Additionally, the SEC and the FASB's Emerging Issues Task Force continue to address revenues, stock option accounting related accounting issues. We believe that we are in compliance with all of the rules and related guidance as they currently exist. However, any changes to accounting principles generally accepted in the United States of America in these areas could impact the future accounting of our operations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Foreign Currency Risk*

A significant portion of our business is conducted in currencies other than the U.S. dollar. The functional currency for our foreign operations is the renminbi, the local currency of China, where our operating expenses are predominantly in the local currency. Since most of our operations are conducted in China, most of our costs are incurred in Chinese currency, which subjects us to fluctuations in the exchange rates between the U.S. dollar and the Chinese renminbi. We incur transaction gains or losses resulting from consolidation of expenses incurred in local currencies for these subsidiaries, as well as in translation of the assets and liabilities of these assets at each balance sheet date. These risks may be increased by the fluctuations and revaluations of the Chinese renminbi. Our financial results could be adversely affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets, including the revaluation by China of the renminbi, and any future adjustments that China may make to its currency such as any move it might make to a managed float systems with opportunistic interventions. In the future we may experience foreign exchange losses on our non-functional currency denominated receivables and payables to the extent that we have not mitigated our exposure utilizing foreign currency forward exchange contracts. Foreign exchange losses could have a materially adverse effect on our operating results and cash flows.

We do not currently use short-term forward exchange contracts for hedging purposes to reduce the effects of adverse foreign exchange rate movements. We had previously purchased foreign exchange contracts to hedge against certain trade accounts receivable denominated in Japanese yen. The change in the fair value of the forward contracts was recognized as part of the related foreign currency transactions as they occur. As of June 30, 2010, we had no outstanding commitments with respect to foreign exchange contracts.

During the second quarter of 2010, we recorded a net realized foreign exchange gain of \$41,000, included as part of other income in our consolidated statements of operations. We incurred foreign currency transaction exchange gains and losses due to operations in general. It is uncertain whether these currency trends will continue. In the future we may experience foreign exchange losses on our non-functional currency denominated receivables and payables to the extent that we have not mitigated our exposure utilizing foreign currency forward exchange contracts. Foreign exchange losses could have a materially adverse effect on our operating results and cash flows. During the second quarter of 2010, we recorded unrealized foreign currency gain of \$189,000, included in the balance of accumulated other comprehensive income on our consolidated balance sheet.

In July 2005, China agreed to a shift in Chinese currency policy. It established a 2% revaluation of the renminbi and referenced the renminbi to a basket of currencies, with a daily trading band of +/-0.3%. Depending on market conditions and the state of the Chinese economy, it is possible that China will make more adjustments in the future. Over the next five to ten years, China may move to a managed float system, with opportunistic interventions. This may negatively impact the United States dollar and U.S. interest rates, which, in turn, could negatively impact our operating results and financial condition. The functional currency of our Chinese subsidiary, including our joint ventures, is the local currency; since most of our operations are conducted in China, most of our costs are incurred in Chinese currency, which subjects us to fluctuations in the exchange rates between the U.S. dollar and the Chinese renminbi. We incur transaction gains or losses resulting from consolidation of expenses incurred in local currencies for these subsidiaries, as well as in translation of the assets and liabilities of these assets at

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each balance sheet date. These risks may be increased by the fluctuation and revaluation of the Chinese renminbi. If we do not effectively manage the risks associated with this currency risk, our revenue, cash flows and financial condition could be adversely affected.

### *Interest Rate Risk*

Cash and cash equivalents earning interest and certain variable rate debt instruments are subject to interest rate fluctuations. The following table sets forth the probable impact of a 10% change in interest rates (in thousands):

Instrument	Balance as of June 30, 2010	Current Interest Rate	Projected Annual Interest Income/(Expense)	Proforma 10% Interest Rate Decline Income/(Expense)	Proforma 10% Interest Rate Increase Income/(Expense)
Cash	\$ 20,339	0.50%	\$ 102	\$ 92	\$ 112
Cash equivalents	55	0.50	0	0	0
Investment in debt and equity instruments	18,531	2.74	508	457	559
Tenant improvement loan	(458)	4.00	(18)	(16)	(20)
			\$ 592	\$ 533	\$ 651



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The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Financial instruments that potentially subject us to concentration of credit risk consist primarily of cash and cash equivalents, short-term investments, and trade accounts receivable. We invest primarily in money market accounts, commercial paper instruments, and investment grade securities. We are exposed to credit risks in the event of default by the issuers to the extent of the amount recorded on the consolidated balance sheets. These securities are generally classified as available-for-sale and consequently are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of estimated tax. Our cash, cash equivalents and short-term investments are in high-quality securities placed with Citicorp. We have no investments in auction rate securities. As of June 30, 2010, we had approximately \$7.5 million in one remaining principal protected note with Citigroup with a fair value of approximately \$7.5 million. We will decrease our exposure to Citigroup as this principal protected note comes due and the underlying assets are placed into diversified securities.

***Accounts Receivable Risk***

We perform periodic credit evaluations of our customers' financial condition and generally do not require collateral. Two customers each accounted for 10% or more of our trade accounts receivable balance as of June 30, 2010 at 30%, and 11%, respectively.

***Equity Risk***

We maintain minority investments in two privately-held companies other than our strategic investments in private companies located in China. These minority investments in two privately-held companies are reviewed for other than temporary declines in value on a quarterly basis. These investments are classified as other assets in the consolidated balance sheets and are accounted for under the cost method as we do not have the ability to exercise significant influence over their operations. We monitor our investments for impairment and record reductions in carrying value when events or changes in circumstances indicate that the carrying value may not be recoverable. Reasons for other than temporary declines in value include whether the related company would have insufficient cash flow to operate for the next twelve months, significant changes in the operating performance and changes in market conditions. As of June 30, 2010, the minority investments totaled \$0.7 million.

**ITEM 4. CONTROLS AND PROCEDURES**

***Disclosure Controls and Procedures***

Under the supervision and with the participation of our management, our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as such terms are defined under Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report in ensuring that information required to be disclosed on SEC reports is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

*Changes in Internal Control Over Financial Reporting*

No change in our internal control over financial reporting was made in the three months ended June 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time we may be involved in judicial or administrative proceedings concerning matters arising in the ordinary course of business. We do not expect that any of these matters, individually or in the aggregate, will have a material adverse effect on our business, financial condition, cash flows or results of operation.

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**Item 1A. Risk Factors**

There are no material changes from the risk factors set forth under Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

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

None

**Item 3. Defaults upon Senior Securities**

None

**Item 4. Reserved**

**Item 5. Other Information**

None

**Item 6. Exhibits**

**a. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
3.1(1)	Restated Certificate of Incorporation
3.2(2)	Certificate of Designation, Preferences and Rights of Series A Preferred Stock.

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- 3.3(3) Second Amended and Restated By Laws
- 4.2(4) Rights Agreement dated April 24, 2001 by and between AXT, Inc. and ComputerShare Trust Company, Inc.

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31.1	Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

---

(1) Incorporated by reference to the exhibit as of the same number as filed with the SEC in our Annual Report on Form 10-K for the year ended December 31, 1998.

(2) Incorporated by reference to Exhibit 3.1 to our Form 8-K as filed with the SEC on June 14, 1999.

(3) Incorporated by reference to Exhibit 3.4 to our Form 8-K as filed with the SEC on May 30, 2001.

(4) Incorporated by reference to the exhibit of the same number as filed with the SEC in our Form 8-K on May 30, 2001.

(5) Incorporated by reference to Exhibit 10.31 to our Form 8-K as filed with the SEC on February 2, 2010.

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**SIGNATURES**

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

AXT, INC.

Dated: August 9, 2010

By:

/s/ MORRIS S. YOUNG  
Morris S. Young  
*Chief Executive Officer*  
*(Principal Executive Officer)*

/s/ RAYMOND A. LOW  
Raymond A. Low  
*Chief Financial Officer*  
*(Principal Financial Officer and Principal Accounting Officer)*

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
3.1(1)	Restated Certificate of Incorporation
3.2(2)	Certificate of Designation, Preferences and Rights of Series A Preferred Stock (which is incorporated herein by reference to Exhibit 2.1 to the registrant's form 8-K dated May 28, 1999).
3.3(3)	Second Amended and Restated By Laws
4.2(4)	Rights Agreement dated April 24, 2001 by and between AXT, Inc. and ComputerShare Trust Company, Inc.
31.1	Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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