AXT INC
Form 10-Q
May 10, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

for the quarterly period ended March 31, 2012

Or

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

for the transition period from to

Commission File Number 000-24085

AXT, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	94-3031310
(State or other jurisdiction of Incorporation or organization)	(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)

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 x No o

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 x No o

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 o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	Outstanding at April 27, 2012
Common Stock, $0.001 par value	32,321,687

AXT, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AXT, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except per share data)

	March 31, 2012	December 31, 2011 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$31,156	$ 26,156
Short-term investments	11,099	5,505
Accounts receivable, net of allowances of $190 and $124 as of March 31, 2012 and December 31, 2011, respectively	16,628	17,966
Inventories	42,028	46,012
Related party notes receivable – current	414	412
Prepaid expenses and other current assets	6,573	7,052
Total current assets	107,898	103,103
Long-term investments	3,795	8,981
Property, plant and equipment, net	34,566	34,282
Related party notes receivable – long-term	2,034	2,021
Other assets	13,983	14,101
Total assets	$162,276	$ 162,488
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,177	$ 3,286
Accrued liabilities	7,155	7,597
Total current liabilities	11,332	10,883
Long-term portion of royalty payments	3,925	4,125
Other long-term liabilities	119	431
Total liabilities	15,376	15,439
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 2,000 shares authorized; 883 shares issued and outstanding as of March 31, 2012 and December 31, 2011 (Liquidation preference of $5.8 million as of March 31, 2012 and December 31, 2011)	3,532	3,532
Common stock, $0.001 par value per share; 70,000 shares authorized; 32,322 and 32,222 shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively	32	32
Additional paid-in capital	192,054	191,554
Accumulated deficit	(60,522)	(62,157)
Accumulated other comprehensive income	6,189	5,818
AXT, Inc. stockholders' equity	141,285	138,779
Noncontrolling interests	5,615	8,270
Total stockholders' equity	146,900	147,049

Total liabilities and stockholders’ equity	$162,276	$ 162,488

See accompanying notes to condensed consolidated financial statements.

(1) The condensed consolidated balance sheet at December 31, 2011 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 March 31, 2012	Three Months Ended March 31, 2011
Revenue	$23,486	$24,566
Cost of revenue	15,292	13,906
Gross profit	8,194	10,660
Operating expenses:		
Selling, general and administrative	3,785	3,690
Research and development	835	505
Total operating expenses	4,620	4,195
Income from operations	3,574	6,465
Interest income, net	88	87
Other expense, net	(335)	(363)
Income before provision for income taxes	3,327	6,189
Provision for income taxes	(375)	(902)
Net income	2,952	5,287
Less: Net income attributable to noncontrolling interests	(1,317)	(1,079)
Net income attributable to AXT, Inc.	$1,635	$4,208
Net income attributable to AXT, Inc. per common share:		
Basic	$0.05	$0.13
Diluted	$0.05	$0.13
Weighted average number of common shares outstanding:		
Basic	32,034	31,718
Diluted	33,018	33,199

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited, in thousands)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net income	$2,952	$5,287
Other comprehensive income, net of tax:		
Change in foreign currency translation gain (loss), net of tax	338	158
Change in unrealized gain (loss) on available-for-sale investments, net of tax	100	(47)
Total other comprehensive income, net of tax	438	111
Comprehensive income	3,390	5,398
Less: Comprehensive income attributable to the noncontrolling interests	(1,384)	(1,122)
Comprehensive income attributable to AXT, Inc.	$2,006	$4,276

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Cash flows from operating activities:		
Net income	$2,952	$5,287
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	907	815
Amortization of marketable securities premium	71	98
Stock-based compensation	281	207
Realized loss on sale of investments	—	4
Loss on disposal of property, plant and equipment	29	—
Changes in assets and liabilities:		
Accounts receivable, net	1,350	3,916
Inventories	4,030	(3,773)
Prepaid expenses and other current assets	491	(2,926)
Other assets	124	(69)
Accounts payable	883	(1,014)
Accrued liabilities	(1,108)*	(624)
Other long-term liabilities	(459)	(395)
Net cash provided by operating activities	9,551	1,526
Cash flows from investing activities:		
Purchases of property, plant and equipment	(1,124)	(2,787)
Purchases of available-for-sale securities	(3,079)	(10,002)
Proceeds from maturities of available-for-sale securities	2,700	11,923
Net cash used in investing activities	(1,503)	(866)
Cash flows from financing activities:		
Proceeds from common stock options exercised	219	357
Dividends paid by joint ventures	(3,384)*	(1,636)
Net cash used in financing activities	(3,165)	(1,279)
Effect of exchange rate changes on cash and cash equivalents	117	168
Net increase (decrease) in cash and cash equivalents	5,000	(451)
Cash and cash equivalents at the beginning of the period	26,156	23,724
Cash and cash equivalents at the end of the period	$31,156	$23,273

*Dividends accrued but not paid by joint ventures of $655 was included in accrued liabilities as of March 31, 2012.

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 all of 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 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC") on March 15, 2012.

The condensed consolidated financial statements include the accounts of AXT and our majority-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated. Investments in business entities in which we do not have control, but have the ability to exercise significant influence over operating and financial policies (generally 20-50% ownership), are accounted for by the equity method. For majority-owned subsidiaries, we reflect the noncontrolling interests of the portion we do not own on our Condensed Consolidated Balance Sheets in Equity and in our Condensed Consolidated Statements of Operations.

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. The amortization of stock compensation under ASC 718 is based on the single-option approach. All of the Company's stock compensation is accounted for as an equity instrument.

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

	Three Months Ended March 31,	
	2012	2011

Stock-based compensation in the form of employee stock options, included in:

Cost of revenue	$ 18	$ 20
Selling, general and administrative	238	176
Research and development	25	11
Total stock-based compensation	281	207
Tax effect on stock-based compensation	—	—
Net effect on net income	$ 281	$ 207
Effect on net income attributable to AXT, Inc. per common share:		
Basic	$ 0.01	$ 0.01
Diluted	$ 0.01	$ 0.01

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As of March 31, 2012, the compensation costs related to unvested stock options granted to employees under our stock option plan but not yet recognized was approximately $1.9 million, net of estimated forfeitures of $130,000. These costs will be amortized on a straight-line basis over a weighted-average period of approximately 2.6 years and will be adjusted for subsequent changes in estimated forfeitures. We elected not to capitalize any stock-based compensation to inventory as of March 31, 2012 due to the immateriality of the amount.

We estimate the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of ASC 718. There were 80,000 and zero stock options granted in the three months ended March 31, 2012 and 2011, respectively. The fair value of our stock options granted to employees for the three months ended March 31, 2012 was estimated using the following weighted-average assumptions:

	Three months ended March 31, 2012
Expected term (in years)	4.0
Volatility	73.41%
Expected dividend	0%
Risk-free interest rate	0.76%
Estimated forfeitures	4.24%
Weighted-average fair value	$ 3.05

The following table summarizes the stock option transactions during the three months ended March 31, 2012 (in thousands, except per share data):

Stock Options	Shares	Weighted-average Exercise Price	Weighted-average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Balance as of January 1, 2012	2,380	$3.25	6.25	$3,456
Granted	80	5.61		
Exercised	(100)	2.19		
Canceled and expired	—	—		
Balance as of March 31, 2012	2,360	$3.37	6.36	$7,151
Options vested and expected to vest as of March 31, 2012	2,307	$3.35	6.30	$7,059
Options exercisable as of March 31, 2012	1,394	$2.78	4.77	$5,089

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing price of $6.35 on March 30, 2012, 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 March 31, 2012 was 1,357,196.

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The options outstanding and exercisable as of March 31, 2012 were in the following exercise price ranges:

	Options Outstanding as of March 31, 2012					Options Exercisable as of March 31, 2012		
Range of Exercise Price		Shares		Weighted-average Exercise Price	Weighted-average Remaining Contractual Life	Shares		Weighted-Average Exercise Price
$	1.18 - $1.38	407,001	$	1.31	2.23	407,001	$	1.31
$	1.40 - $1.40	1,094	$	1.40	2.95	1,094	$	1.40
$	1.59 - $1.59	328,460	$	1.59	7.04	220,592	$	1.59
$	1.88 - $1.91	8,000	$	1.90	2.50	8,000	$	1.90
$	2.04 - $2.04	441,775	$	2.04	7.57	254,269	$	2.04
$	2.19 - $4.09	177,510	$	2.56	1.20	177,510	$	2.56
$	4.79 - $4.79	366,500	$	4.79	9.58	0	$	0.00
$	4.81 - $5.61	144,610	$	5.26	7.61	64,610	$	4.84
$	5.83 - $5.83	362,450	$	5.83	8.34	152,325	$	5.83
$	6.31 - $9.69	122,295	$	7.39	4.74	108,628	$	7.34
		2,359,695	$	3.37	6.36	1,394,029	$	2.78

There were 100,000 and 100,178 options exercised in the three months ended March 31, 2012 and 2011, respectively. The total intrinsic value of options exercised for the three months ended March 31, 2012 and 2011 was $365,000 and $637,000, respectively. Cash received from options exercised for the three months ended March 31, 2012 and 2011 was $219,000 and $357,000, respectively.

Restricted stock awards

A summary of activity related to restricted stock awards for the three months ended March 31, 2012 is presented below:

Stock Awards	Shares		Weighted-Average Grant Date Fair Value
Non-vested as of January 1, 2012	223,127	$	4.47
Granted	—	$	—
Vested	—	$	—
Non-vested as of March 31, 2012	223,127	$	4.47

As of March 31, 2012, we had $770,000 of unrecognized compensation expense related to restricted stock awards, which will be recognized over the weighted average period of 2.2 years. During the three months ended March 31, 2012, no shares of restricted stock awards vested.

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Note 3. Investments and Fair Value Measurements

Our cash, cash equivalents and investments are classified as follows (in thousands):

	March 31, 2012				December 31, 2011			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value
Classified as:								
Cash	$30,195	$ —	$ —	$30,195	$25,299	$ —	$ —	$25,299
Cash equivalents:								
Money market fund	961	—	—	961	857	—	—	857
Total cash equivalents	961	—	—	961	857	—	—	857
Total cash and cash equivalents	31,156	—	—	31,156	26,156	—	—	26,156
Investments:								
Certificates of deposit	5,439	4	(12)	5,431	3,561	5	(3)	3,563
US Treasury and agency securities	1,200	—	—	1,200	1,200	—	(1)	1,199
Corporate bonds	8,289	11	(37)	8,263	9,859	2	(137)	9,724
Total investments	14,928	15	(49)	14,894	14,620	7	(141)	14,486
Total cash, cash equivalents and investments	$46,084	$ 15	$ (49)	$46,050	$40,776	$ 7	$ (141)	$40,642
Contractual maturities on investments:								
Due within 1 year	$11,129			$11,099	$5,521			$5,505
Due after 1 through 5 years	3,799			3,795	9,099			8,981
	$14,928			$14,894	$14,620			$14,486

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 months ended March 31, 2012 and 2011, the proceeds from maturities of available-for-sale securities were $2.7 million and $11.9 million, respectively and we had gross realized losses of zero and $4,000, respectively.

The gross unrealized losses related to our portfolio of available-for-sale securities were primarily due to changes in interest rates and market and credit conditions of the underlying securities. We have determined that the gross unrealized losses on some of our available-for-sale securities as of March 31, 2012 are temporary in nature. We periodically review 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 summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of March 31, 2012 (in thousands):

	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	$3,267	$(12)	$—	$—	$3,267	$(12)
Corporate bonds	5,116	(37)	—	—	5,116	(37)
Total in loss position	$8,383	$(49)	$—	$—	$8,383	$(49)

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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 10). The investment balances for all the companies, including indirect minority investments in privately-held companies through our consolidated joint ventures, are accounted for under the equity method and are included in “other assets” in the consolidated balance sheets and totaled $8.6 million and $8.3 million as of March 31, 2012 and December 31, 2011, respectively. We also maintain minority investments in other unconsolidated privately-held companies which are accounted for under the cost method. As of both March 31, 2012 and December 31, 2011, our investments in these unconsolidated privately-held companies had a carrying value of $392,000 and are also included in “other assets” in the consolidated balance sheets.

Fair Value Measurements

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. Level 3 instrument valuations are obtained from unobservable inputs in which there is little or no market data, which require us to develop our own assumptions. As of March 31, 2012, we did not have any Level 3 assets or liabilities. This hierarchy requires us to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, we measure certain financial assets and liabilities at fair value, primarily consisting of our short-term and long-term investments.

The type of instrument valued based on quoted market prices in active markets include our money market funds, which are generally classified within Level 1 of the fair value hierarchy. We classify all of our available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of these financial instruments having Level 2 inputs were derived from quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 as of March 31, 2012 (in thousands):

	Balance as of March 31, 2012	Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets:			
Cash equivalents and investments:			
Money market fund	$ 961	$ 961	$ —
Certificates of deposit	5,431	—	5,431
US Treasury and agency securities	1,200	—	1,200
Corporate bonds	8,263	—	8,263
Total	$ 15,855	$ 961	$ 14,894
Liabilities	$ —	$ —	$ —

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 investments in privately-held companies accounted for by equity and cost method (See Note 10). We did not record other-than-temporary impairment charges for either of these investments during the three months ended March 31, 2012 and 2011.

Note 4. Inventories

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

	March 31, 2012	December 31, 2011
Inventories:		
Raw materials	$ 22,431	$ 25,460
Work in process	14,598	15,753
Finished goods	4,999	4,799
	$ 42,028	$ 46,012

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Note 5. Related Party Transactions

In August 2011, our consolidated joint venture, Beijing JiYa Semiconductor Material Co., Ltd (JiYa), entered into a non-interest bearing note agreement in the amount of $1.6 million (Rmb 10,485,200) with one of its equity investment entities. Under the loan agreement, JiYa loaned $779,000 (Rmb 4,959,000) to its equity investment entity in August 2011 and the remaining amount of $868,000 (Rmb 5,526,200) was loaned during the three months ending March 31, 2012. The term of the loan is two years and ten months and the equity investment entity will repay JiYa in three installments with the first installment of $414,000 (Rmb 2,620,000) due in December 2012, the second installment of $829,000 (Rmb 5,240,000) due in December 2013, and last installment of $415,000 (Rmb 2,625,200) due in May 2014. As of March 31, 2012, we included $414,000 (Rmb 2,620,000) in “Related party notes receivable – short term” and $1.2 million (Rmb 7,865,200) in “Related party notes receivable – long term” in the consolidated balance sheets.

In August 2011, our consolidated joint venture, Nanjing Jin Mei Gallium Co., Ltd. loaned $790,000 (Rmb 5,000,000) to its equity investment entity for construction purposes. As of March 31, 2012, this balance was included in “Related party notes receivable – long term” in the consolidated balance sheets.

Note 6. Accrued Liabilities

The components of accrued liabilities are summarized below (in thousands):

	March 31, 2012	December 31, 2011
Accrued compensation and related charges	$ 1,167	$ 1,807
Current portion of royalty payments	1,138	1,375
Accrued product warranty	997	1,003
Dividends payable by joint ventures	655	—
Loan commitment for related party notes receivable	—	868
Accrued professional services	299	650
Other accrued liabilities	2,899	1,894
	$ 7,155	$ 7,597

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Note 7. Net Income Per Share

Basic net income per share is computed using the weighted average number of common shares outstanding during the periods less shares of common stock subject to repurchase and non-vested stock awards. Diluted net income per share is computed using the weighted average number of common shares outstanding and potentially dilutive common shares outstanding during the periods. The dilutive effect of outstanding stock options and restricted stock awards is reflected in diluted earnings per share by application of the treasury stock method. Potentially dilutive common shares consist of common shares issuable upon the exercise of stock options. Potentially dilutive common shares are excluded in net loss periods, as their effect would be anti-dilutive.

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

	Three Months Ended March 31, 2012	2011
Numerator:		
Net income attributable to AXT, Inc.	$ 1,635	$ 4,208
Less: Preferred stock dividends	(44)	(44)
Net income available to common stockholders	$ 1,591	$ 4,164
Denominator:		
Denominator for basic net income per share - weighted average common shares	32,034	31,718
Effect of dilutive securities:		
Common stock options	903	1,324
Restricted stock awards	81	157
Denominator for dilutive net income per common share	33,018	33,199
Net income attributable to AXT, Inc. per common share:		
Basic	$ 0.05	$ 0.13
Diluted	$ 0.05	$ 0.13
Options excluded from diluted net income per share as the impact is anti-dilutive	878	65
Restricted stock excluded from diluted net income per share as the impact is anti-dilutive	74	154

The 883,000 shares of $0.001 par value Series A preferred stock issued and outstanding as of March 31, 2012 and December 31, 2011, valued at $3,532,000 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 $4 per share liquidation preference over common stock, and must be paid before any distribution is made to common stockholders. These preferred shares were issued to Lyte Optronics, Inc. stockholders in connection with the completion of our acquisition of Lyte Optronics, Inc. on May 28, 1999.

Note 8. Stockholders' Equity

Consolidated Statements of Changes in Equity

	Preferred Stock	Common Stock	Additional	Accumulated Deficit	Other Comprehensive	AXT, Inc. stockholders	Noncontrolling interests	Total stockholders'

			Paid In Capital		Income/(loss)	equity		equity
Balance as of December 31, 2011	$3,532	$32	$ 191,554	$ (62,157)	$ 5,818	$ 138,779	$ 8,270	$ 147,049
Common stock options exercised			219			219		219
Stock-based compensation			281			281		281
Comprehensive income								
Net income				1,635		1,635	1,317	2,952
Net dividends declared by joint ventures							(4,039)	(4,039)
Change in unrealized (loss) gain on marketable securities					100	100		100
Currency translation adjustment					271	271	67	338
Balance as of March 31, 2012	$3,532	$32	$ 192,054	$ (60,522)	$ 6,189	$ 141,285	$ 5,615	$ 146,900

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Note 9. Segment Information and Foreign Operations

Segment Information

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 Chief 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 condensed consolidated financial statements.

Product Information

	Three Months Ended March 31,	
	2012	2011
Revenue by product type:		
GaAs substrates	$ 12,231	$ 15,892
InP substrates	1,451	1,332
Ge substrates	2,630	2,990
Raw materials and other	7,174	4,352
Total	$ 23,486	$ 24,566

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Geographical Information

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

	Three Months Ended March 31,	
	2012	2011
Net revenues:		
North America*	$ 5,167	$ 3,792
Europe	4,565	5,184
Japan	2,189	3,028
Taiwan	2,046	2,864
Asia Pacific (excluding Japan and Taiwan)	9,519	9,698
Total	$ 23,486	$ 24,566

*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	
	March 31, 2012	December 31, 2011
Long-lived assets by geographic region:		
North America	$ 461	$ 484
China	34,105	33,798
	$ 34,566	$ 34,282

Significant Customers

One customer represented 17.4% of the revenue for the three months ended March 31, 2012 while one customer represented 15.9% of revenue for the three months ended March 31, 2011. Our top five customers represented 46.3% and 36.5% of revenue for the three months ended March 31, 2012 and 2011, respectively.

We perform ongoing credit evaluations of our customers' financial condition, and limit the amount of credit extended when deemed necessary, but generally do not require collateral. Two customers accounted for 10% or more of our trade accounts receivable balance as of March 31, 2012 at 25% and 14%, respectively. Two customers accounted for 10% or more of our trade accounts receivable balance at as of December 31, 2011 at 33% and 12%, respectively.

Note 10. 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):

Investment Balance as of

Company		March 31, 2012		December 31, 2011	Accounting Method	Ownership Percentage	
Beijing JiYa Semiconductor Material Co., Ltd	$	3,331	$	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	%
	$	4,333	$	1,998			
Jiangsu Dongfang Electric, Inc.	$	2,137	$	2,167	Equity	46	%
Xilingol Tongli Germanium Co. Ltd		3,887		3,881	Equity	25	%
Emeishan Jia Mei High Purity Metals Co., Ltd		1,001		1,001	Equity	25	%
	$	7,025	$	7,049			

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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 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 board.

Our ownership of Beijing BoYu Semiconductor Vessel Craftwork Technology Co., Ltd (BoYu) is 70%. We continue to consolidate BoYu as we have a significant influence in management and have a majority control of the board. Our Chief Executive Officer is chairman of the BoYu board, while our president of China operations and our vice president of China administration are also members of the 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 without input from us.

During the three months ended March 31, 2012 and 2011, the three consolidated joint ventures generated $2.6 million and $2.6 million of income, respectively, of which $1.3 million and $1.1 million, respectively was allocated to minority interests, resulting in $1.3 million and $1.5 million, respectively, to our net income.

The investment balances for these three equity investment entities are included in “other assets” in our condensed consolidated balance sheets and totaled $7.0 million as of March 31, 2012 and December 31, 2011, respectively. We own 46% of the ownership interests in one of these companies, which was added in the quarter ended June 30, 2011, and 25% in each of the other two companies. These three companies are not considered variable interest entities because:

- all three 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 any of these companies.

Our net equity losses from these three minority-owned joint ventures that are not consolidated are recorded as other expenses, net and totaled $37,000 for the three months ended March 31, 2012. Our equity earnings from the two-minority owned joint ventures that are not consolidated are recorded as other income, net and totaled $73,000 for the three months ended March 31, 2011.

Net income recorded from all of these joint ventures was $1.2 million and $1.6 million for the three months ended March 31, 2012 and 2011, respectively. Undistributed retained earnings relating to our investments in all these companies were $25.1 million and $23.8 million as of March 31, 2012 and December 31, 2011, respectively.

We also maintain minority investments indirectly in privately-held companies through our consolidated joint ventures. These minority investments are accounted for under the equity method in the books of our consolidated joint ventures. As of March 31, 2012 and December 31, 2011, our consolidated joint venture included the minority investments in “other assets” in the condensed consolidated balance sheets with a carrying value of $1.5 million and $1.3 million, respectively.

We also maintain minority investments directly in two privately-held companies accounted for under the cost method and we do not have the ability to exercise significant influence over their operations. As of March 31, 2012 and December 31, 2011, our investments in these two unconsolidated privately-held companies had a carrying value of $392,000 and are included in “other assets” in the condensed consolidated balance sheets.

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Note 11. Commitments and Contingencies

Indemnification Agreements

We enter into standard indemnification arrangements with our customers 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 their 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 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 months ended March 31, 2012 and 2011 (in thousands):

	Three Months Ended March 31,	
	2012	2011
Beginning accrued warranty and related costs	$ 1,003	$ 740
(Benefits)/Charges to cost of revenue	(108)	(15)
Actual warranty expenditures	102	73
Ending accrued warranty and related costs	$ 997	$ 798

Contractual Obligations

We lease certain office space, manufacturing facilities and equipment under long-term operating leases expiring at various dates through February 2016. The lease agreement of the facility at Fremont, California with approximately 27,760 square feet commenced December 1, 2008 for a term of seven years, with an option by us to cancel the lease after five years, upon forfeiture of the security deposit and payment of one-half of the fifth year's rent.

We entered into a royalty agreement with a vendor effective December 3, 2010 with a term of eight years, terminating December 31, 2018. We and our related companies are granted a worldwide, nonexclusive, royalty bearing, irrevocable license to certain patents for the term on the agreement. We shall pay a total of $7.0 million royalty payment over eight years that began in 2011 based on future royalty bearing sales.

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Outstanding contractual obligations as of March 31, 2012 are summarized as follows (in thousands):

		Payments due by period			
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases	$1,284	$ 382	$686	$216	$—
Royalty agreement	5,062	1,137	1,600	1,319	1,006
Total	$6,346	$ 1,519	$2,286	$1,535	$1,006

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 March 31, 2012, we do 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 12. Foreign Exchange Transaction Losses

We incurred foreign currency transaction exchange losses of $165,000 and $196,000 for the three months ended March 31, 2012 and 2011, respectively. These amounts are included in “Other expense, net” on the condensed consolidated statements of operations.

Note 13. Income Taxes

We account for income taxes in accordance with ASC topic 740, Income Taxes (“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 recognize interest and penalties related to uncertain tax positions in income tax expense. As of March 31, 2012, we do 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 on January 1, 2007, 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 carry-forwards 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. Provision for income taxes for three months ended March 31, 2012 and 2011 was mostly related to our China subsidiary and our China joint venture operations. We have made a tax election in China whereby certain minimum foreign withholding taxes are treated as an expense and not a tax credit. Besides the state taxes liabilities, no Federal income tax expense has been provided for the three months ended March 31, 2012 due to the valuation allowance being utilized.

Note 14. Recent Accounting Pronouncements

There have been no new accounting pronouncements during the three months ended March 31, 2012, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December

31, 2011, that are of material significance, or potential significance, to the Company.

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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 expand our markets and increase sales, industry trends, customer qualifications of our products, gross margins, the impact of the adoption of certain accounting pronouncements, our investments in capital projects, and our belief that we have adequate cash and investments to meet our needs over the next 12 months. 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 ou 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, 2011 and the condensed consolidated financial statements included elsewhere in this report.

Overview

We are a leading 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”	· Power amplifiers and radio frequency integrated circuits for wireless handsets (cell phones) · Direct broadcast television · High-performance transistors · Satellite communications
GaAs (semi-conducting)	2”, 3”, 4”	· High brightness light emitting diodes · Lasers · Optical couplers
InP	2”, 3”, 4”	· Broadband and fiber optic communications
Ge	2”, 4”, 6”	· Satellite and terrestrial solar cells · Optical applications

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, Europe or Japan. We also have joint ventures in China which provide us pricing advantages, 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, for accounting purposes, the joint ventures in which we have majority or controlling financial interest and significant influence on management, and employ equity accounting for the joint ventures in which we have a smaller ownership 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 representatives in Europe and Asia to market our substrates. We believe that, as the demand for compound semiconductor substrates increases, we are positioned to leverage our PRC-based manufacturing capabilities and access to favorably priced raw materials to increase our market share.

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Critical Accounting Policies and Estimates