AXT INC
Form 10-Q
August 10, 2009
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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 June 30, 2009

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 o 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 July 30, 2009
Common Stock, $0.001 par value	30,664,390

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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)

	June 30, 2009	December 31, 2008
Assets:		
Current assets:		
Cash and cash equivalents	$ 12,413	$ 13,566
Short-term investments	18,216	17,756
Accounts receivable, net of allowances of $358 and $663 as of June 30, 2009 and December 31, 2008, respectively	12,883	11,497
Inventories, net	28,304	35,082
Prepaid expenses and other current assets	1,734	3,131
Total current assets	73,550	81,032
Property, plant and equipment, net	20,957	22,184
Restricted deposits	3,000	3,013
Other assets	5,531	5,433
Total assets	$ 103,038	$ 111,662
Liabilities and stockholders equity:		
Current liabilities:		
Accounts payable	$ 4,347	$ 6,657
Accrued liabilities	4,574	4,453
Line of credit	3,000	3,013
Current portion of long-term debt	74	73
Total current liabilities	11,995	14,196
Long-term debt, net of current portion	459	496
Other long-term liabilities	64	94
Total liabilities	12,518	14,786
Commitments and contingencies (Note 11)		
Stockholders equity:		
Preferred stock, $0.001 par value per share; 2,000 shares authorized; 883 shares issued and outstanding as of June 30, 2009 and December 31, 2008, respectively	3,532	3,532
Common stock, $0.001 par value per share; 70,000 shares authorized; 30,664 and 30,513 shares issued and outstanding as of June 30, 2009 and December 31, 2008, respectively	30	30
Additional paid-in capital	187,373	186,754
Accumulated deficit	(106,028)	(99,232)
Accumulated other comprehensive income	3,432	2,580
Total AXT, Inc. stockholders equity	88,339	93,664
Noncontrolling interests	2,181	3,212
Total stockholders equity	90,520	96,876

Total liabilities and stockholders equity	$ 103,038	$ 111,662

See accompanying notes to condensed consolidated financial statements.

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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,	
	2009	2008	2009	2008
Revenue	$ 13,055	$ 19,932	$ 20,709	$ 39,566
Cost of revenue	10,539	13,488	18,430	26,901
Gross profit	2,516	6,444	2,279	12,665
Operating expenses:				
Selling, general and administrative	3,486	3,578	7,492	7,245
Research and development	355	569	815	1,073
Impairment on assets held for sale				83
Restructuring charge			507	
Total operating expenses	3,841	4,147	8,814	8,401
Income (loss) from operations	(1,325)	2,297	(6,535)	4,264
Interest income, net	34	241	78	365
Other income (expense), net	321	(518)	(101)	409
Income (loss) before provision for income taxes	(970)	2,020	(6,558)	5,038
Provision for income taxes	308	635	312	1,195
Net income (loss)	(1,278)	1,385	(6,870)	3,843
Less: Net income (loss) attributable to noncontrolling interest	(2)	(648)	74	(1,147)
Net income (loss) attributable to AXT, Inc.	$ (1,280)	$ 737	$ (6,796)	$ 2,696
Net income (loss) attributable to AXT, Inc. per common share:				
Basic	$ (0.04)	$ 0.02	$ (0.23)	$ 0.09
Diluted	$ (0.04)	$ 0.02	$ (0.23)	$ 0.08
Weighted average number of common shares outstanding:				
Basic	30,439	30,421	30,437	30,403
Diluted	30,439	31,562	30,437	31,573

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,	
	2009	2008
Cash flows from operating activities:		
Net income (loss) attributable to AXT, Inc.	$ (6,796)	$ 2,696
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation	1,570	967
Accretion of marketable securities premium	(6)	(2)
Loss (gain) on disposal of property, plant and equipment	4	(2)
Impairment on assets held for sale		83
Stock-based compensation	579	321
Restructuring charge	507	
Realized loss (gain) on sale of investments	9	(326)
Changes in assets and liabilities:		
Accounts receivable, net	(1,386)	(1,361)
Inventories	6,766	(13,598)
Prepaid expenses and other current assets	1,394	(2,143)
Other assets	(101)	(439)
Accounts payable	(2,302)	9,459
Accrued liabilities	(385)	752
Other long-term liabilities	(1,057)	(908)
Net cash used in operating activities	(1,204)	(4,501)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(390)	(3,079)
Proceeds from sale of property, plant and equipment		4
Proceeds from sale of assets held for sale		5,057
Purchases of marketable securities	(13)	(11,737)
Proceeds from sale of marketable securities	440	14,495
Decrease in restricted deposits	13	300
Net cash provided by investing activities	50	5,040
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	40	149
Long-term debt payments	(49)	(288)
Net cash used in financing activities	(9)	(139)
Effect of exchange rate changes on cash and cash equivalents	10	512
Net increase (decrease) in cash and cash equivalents	(1,153)	912
Cash and cash equivalents at the beginning of the period	13,566	18,380
Cash and cash equivalents at the end of the period	$ 12,413	$ 19,292

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 a 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 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 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC) on March 31, 2009 and our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2009 filed with the SEC on May 11, 2009.

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 SFAS No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123(R)), 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 SFAS 123(R) 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 SFAS No. 123, *Accounting for Stock-Based Compensation.*

We utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted both before and after the adoption of SFAS 123(R). 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,	
	2009	2008	2009	2008
Stock-based compensation in the form of employee stock options, included in:				
Cost of revenue	$ 10	$ 15	$ 23	$ 31
Selling, general and administrative	93	93	511	215
Research and development	18	43	45	75
Total stock-based compensation	121	151	579	321
Tax effect on stock-based compensation				
Net effect on net income (loss)	$ 121	$ 151	$ 579	$ 321
Effect on basic net income (loss) per share	$ 0.00	$ 0.00	$ 0.02	$ 0.01
Effect on diluted net income (loss) per share	$ 0.00	$ 0.00	$ 0.02	$ 0.01

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As of June 30, 2009 the total compensation costs related to unvested stock-based awards granted to employees under our stock option plan but not yet recognized was approximately $645,000, net of estimated forfeitures of $106,000. These costs will be amortized on a straight-line basis over a weighted-average period of approximately 2.66 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, 2009 due to the immateriality of the amount.

The amortization of stock compensation under SFAS 123(R) 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 SFAS 123(R), and the SEC Staff Accounting Bulletin No. 107. There were no stock option grants made in the three and six months ended June 30, 2009 and no options were granted in the three months ended June 30, 2008. The fair value of our stock options granted to employees for the six months ended June 30, 2008 was estimated using the following weighted-average assumptions:

	Six Months Ended June 30,	
	2009	2008
Expected term (in years)	n/a	4.0
Volatility	n/a	60.79%
Expected dividend	n/a	0%
Risk-free interest rate	n/a	2.69%
Estimated forfeitures	5.07%	4.3%
Weighted-average fair value	n/a	$ 5.09

The following table summarizes the stock option transactions during the six months ended June 30, 2009 (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 December 31, 2008	2,764	$ 2.74		
Granted				
Exercised	(31)	1.31		
Canceled and expired	(118)	4.28		
Options outstanding as of June 30, 2009	2,615	$ 2.68	4.93	$ 116

Options vested and expected to vest as of June 30, 2009	2,587	$	2.68	4.68	$	116
Options exercisable as of June 30, 2009	2,164	$	2.62	4.11	$	115

As of December 31, 2008, options to purchase 1,914,000 shares at a weighted average exercise price of $2.58 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 $1.38 on June 30, 2009, 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, 2009 was 1,153,000.

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The options outstanding and exercisable as of June 30, 2009 were in the following exercise price ranges:

	Options Outstanding as of June 30, 2009			Options Exercisable as of June 30, 2009	
Range of Exercise Price	Shares	Weighted-average Exercise Price	Weighted-average Remaining Contractual Life	Shares	Weighted-Average Exercise Price
$1.17 - $1.38	1,162,425	$ 1.28	4.19	1,141,720	$ 1.28
$1.39 - $1.40	1,094	$ 1.40	5.70	1,094	$ 1.40
$1.41 - $2.24	791,838	$ 1.89	5.25	518,282	$ 2.04
$2.25 - $6.31	605,743	$ 4.99	5.29	453,340	$ 4.72
$6.32 - $41.50	53,500	$ 18.98	2.30	53,500	$ 18.98
	2,614,600	$ 2.68	4.73	2,167,936	$ 2.62

There were 31,000 options exercised in the three and six months ended June 30, 2009. The total intrinsic value of options exercised for the three and six months ended June 30, 2009 was $2,000. Cash received from options exercised for the three months ended June 30, 2009 was $40,000. The total intrinsic value of options exercised for the three and six months ended June 30, 2008 was $117,000 and $245,000, respectively. Cash received from option exercises for the three and six months ended June 30, 2008 was $81,000 and $149,000, respectively.

A summary of activity related to restricted stock awards for the six months ended June 30, 2009 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested restricted stock shares outstanding as of December 31, 2008	78,544	$ 2.12
Restricted stock shares granted	120,908	$ 0.88
Restricted stock shares vested	(3,532)	$ 3.77
Non-vested restricted stock shares outstanding as of June 30, 2009	195,920	$ 1.33

As of June 30, 2009 and 2008, we had $212,000 and $68,000 of unrecognized compensation expense, net of forfeitures, related to restricted stock awards respectively, which will be recognized over the weighted average period of 2.47 and 2.02 years, respectively. During the six months ended June 30, 2009 and 2008, 3,532 shares and 3,536 shares of restricted stock vested respectively.

Note 3. Investments and Fair Value Measurements

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

	June 30, 2009				December 31, 2008			
	Amortized	Gross Unrealized	Gross Unrealized	Fair	Amortized	Gross Unrealized	Gross Unrealized	Fair

	Cost	Gain	(Loss)	Value	Cost	Gain	(Loss)	Value
Classified as:								
Cash	$ 11,807	$	$	$ 11,807	$ 13,385	$	$	$ 13,385
Cash equivalents:								
Money market fund	606			606	181			181
Total cash equivalents	606			606	181			181
Total cash and cash equivalents	12,413			12,413	13,566			13,566
Investments:								
Corporate bonds	21,905		(689)	21,216	22,348		(1,579)	20,769
Total investments	21,905		(689)	21,216	22,348		(1,579)	20,769
Total cash, cash equivalents and investments	$ 34,318		$ (689)	$ 33,629	$ 35,914	$	$ (1,579)	$ 34,335
Contractual maturities on investments:								
Due within 1 year	$ 14,405			$ 14,049	$ 4,060			$ 3,822
Due after 1 through 5 years	7,000			7,167	18,288			16,947
	$ 21,905			$ 21,216	$ 22,348			$ 20,769

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The investments include $3.0 million recorded as restricted deposits on the condensed consolidated balance sheets as of June 30, 2009 and December 31, 2008. The $3.0 million restricted deposit was a drawdown of our line of credit facility, with an annual interest rate of 1.57% as of June 30, 2009.

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, 2009 we had $9,000 gross realized losses on sales of our available-for-sale securities. For the three and six months ended June 30, 2008 we had $133,000 in gross realized losses and $326,000 in gross realized gains on sales of our available-for-sale securities, respectively.

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, 2009 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, 2009 (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:						
Corporate bonds	$ 7,167	$ (333)	$ 14,049	$ (356)	$ 21,216	$ (689)
Total in loss position	$ 7,167	$ (333)	$ 14,049	$ (356)	$ 21,216	$ (689)

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 the two companies accounted for under the equity method are included in other assets in the condensed consolidated balance sheets and totaled $3.9 million and $3.7 million as of June 30, 2009 and December 31, 2008, respectively. We have investments in two unconsolidated privately-held companies accounted for under the cost method. As of June 30, 2009 and December 31, 2008, our investments in the two unconsolidated privately-held companies accounted for under the cost method had a carrying value of $0.4 million and $0.4 million, respectively, and are included in other assets in the condensed consolidated balance sheets.

Fair Value Measurements

On January 1, 2008, we adopted SFAS 157 which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. SFAS 157 applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 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.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with SFAS 157 as of June 30, 2009 (in thousands):

	Balance as of June 30, 2009	Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets:			
Short-term investments:			
Money market fund	$ 606	$ 606	$
Corporate bonds	21,216		21,216
Total	$ 21,822	$ 606	$ 21,216
Liabilities	$	$	$

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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, 2009, 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 2009 or 2008.

Note 4. Inventories, Net

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

	June 30, 2009	December 31, 2008
Inventories, net:		
Raw materials	$ 13,965	$ 17,863
Work in process	11,108	12,961
Finished goods	3,231	4,258
	$ 28,304	$ 35,082

Note 5. Impairment on Assets Held For Sale

During the six months ended June 30, 2008, we completed the sale of our property in Fremont, California. The escrow established to pay the purchase price of the property closed on March 28, 2008. The final purchase price for the property was $5.3 million. We received net proceeds of $5.1 million after deducting commissions and selling expenses. We recorded an impairment charge upon the sale of the property of $83,000. There was no impairment charge for the same six month period ended June 30, 2009.

Note 6. Restructuring Charge

As of June 30, 2009, our restructuring accrual is as follows: (in thousands):

	Restructuring Accrual as of December 31, 2008	Additions	Payments	Restructuring Accrual as of June 30, 2009
Workforce reduction	$	$ 507	$ (507)	$
Total	$	$ 507	$ (507)	$

In March 2009, we reduced the workforce at our Fremont and Beijing facilities by approximately 11 positions that are 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 for the first six months of 2008.

Note 7. 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.

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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,	
	2009	2008	2009	2008
Numerator:				
Net income (loss) attributable to AXT, Inc.	$ (1,280)	$ 737	$ (6,796)	$ 2,696
Less: Preferred stock dividends	(44)	(44)	(88)	(88)
Net income (loss) available to common stockholders	$ (1,324)	$ 693	$ (6,884)	$ 2,608
Denominator:				
Denominator for basic net income per share - weighted average common shares	30,439	30,421	30,437	30,403
Effect of dilutive securities:				
Common stock options		1,141		1,170
Denominator for dilutive net income per common share	30,439	31,562	30,437	31,573
Basic net income (loss) per share	$ (0.04)	$ 0.02	$ (0.23)	$ 0.09
Diluted net income (loss) per share	$ (0.04)	$ 0.02	$ (0.23)	$ 0.08
Options excluded from diluted net loss per share as the impact is anti-dilutive	2,615	130	2,615	130

Note 8. Comprehensive Income (Loss)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income (loss) attributable to AXT, Inc.	$ (1,280)	$ 737	$ (6,796)	$ 2,696
Other comprehensive income, net of tax:				
Change in foreign currency translation gain (loss), net of tax	(42)	502	(40)	1,454
Change in unrealized gain (loss) on available-for-sale investments, net of tax	703	(150)	890	(697)
Total other comprehensive income, net of tax	661	352	850	757
Comprehensive income	(619)	1,089	(5,946)	3,453
Comprehensive income attributable to the noncontrolling interest	1	99	2	299
Comprehensive income (loss) attributable to AXT, Inc.	$ (618)	$ 1,188	$ (5,944)	$ 3,752

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 SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information,* 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.

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Product Information

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenue by product type:				
GaAs substrates	$ 10,108	$ 13,142	$ 15,120	$ 26,862
InP substrates	684	500	1,174	978
Ge substrates	1,217	1,384	1,839	2,769
Raw materials and other	1,046	4,906	2,576	8,957
Consolidated	$ 13,055	$ 19,932	$ 20,709	$ 39,566

Geographical Information

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	
	2009	2008	2009	2008
Revenue by geographic region:				
North America*	$ 2,428	$ 5,437	$ 4,164	$ 10,436
Europe	2,264	3,966	4,477	6,783
Japan	2,038	4,595	3,190	8,735
Taiwan	2,746	2,061	3,435	4,868
Asia Pacific	3,579	3,873	5,443	8,744
Consolidated	$ 13,055	$ 19,932	$ 20,709	$ 39,566

*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	
	June 30, 2009	December 31, 2008
Long-lived assets by geographic region:		
North America	$ 716	$ 867
China	20,241	21,317
	$ 20,957	$ 22,184

Significant Customers

Beginning 2008, we have grouped sales to all IQE companies as sales to one customer. The IQE group typically represents more than 10% of our reported revenue for any given period. Two customers represented 16.0% and 11.6% of revenues for the three month period ended June 30, 2009 while two customers represented 11.6% and 11.1% of revenues for the three month period ended June 30, 2008. Two customers represented 15.3% and 11.5% of revenues for the six month period ended June 30, 2009 while no customers represented more than 10% of revenues for the six month period ended June 30, 2008. Our top five customers represented 43.4% and 45.5% of revenue for the three month periods ended June 30, 2009 and 2008, respectively. Our top five customers represented 40.3% and 34.6% of revenue for the six month periods ended June 30, 2009 and 2008, 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):

Company	Investment Balance as of June 30, 2009	Investment Balance as of December 31, 2008	Accounting Method	Ownership Percentage
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%
Xilingol Tongli Germanium Co. Ltd	3,094	2,906	Equity	25%
Emeishan Jia Mei High Purity Metals Co., Ltd	793	843	Equity	25%

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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 financial officer is chairman of the board, while our chief operating officer, and our president of joint venture operations are members of the board. Our former chief executive officer, formerly a member of this board of directors, resigned from this board on March 17, 2009.

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 operating officer is chairman of the board, while our president of joint venture operations is a member of the board. Our former chief executive officer, formerly a member of this board of directors, resigned from this board on March 17, 2009.

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 operating officer and our president of joint venture operations are members of the board. Our former chief executive officer has resigned as chairman of the board of BoYu effective March 17, 2009.

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.

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 $3.9 million and $3.7 million as of June 30, 2009 and December 31, 2008, 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, 2009 the three consolidated joint ventures had income of $83,000 and a loss of ($167,000), respectively of which $2,000 and ($74,000) were allocated to minority interests, resulting in income of $81,000 and a loss of ($93,000) included in our net loss, respectively. During the three and six months ended June 30, 2008 the three consolidated joint ventures generated $1.6 million and $2.9 million of income, respectively of which $0.6 million and $1.1 million were allocated to minority interests, resulting in $1.0 million and $1.8 million included in our net income, respectively. Our equity earnings from the two-minority owned joint ventures that are not consolidated are recorded as other income (loss), net and totaled $139,000 and $461,000 for the six months ended June 30, 2009 and 2008, respectively. Undistributed retained earnings relating to all our investments in these companies were $11.2 million, and $11.1 million, respectively as of June 30, 2009 and December 31, 2008, respectively.

Our two minority-owned joint ventures that are not consolidated had the following summarized income information (in thousands) for the three and six months ended June 30, 2009 and 2008, respectively.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net Sales	$ 4,111	$ 3,107	$ 6,215	$ 6,114
Gross profit	1,164	1,704	1,851	3,180
Operating income	675	1,222	748	2,227
Net income	526	906	555	1,842

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We have investments in two unconsolidated privately-held companies accounted for under the cost method. As of June 30, 2009 and December 31, 2008, our investments in the two unconsolidated privately-held companies accounted for under the cost method had a carrying value of $0.4 million and $0.4 million, respectively, and are included in other assets in the condensed consolidated balance sheets.

Note 11. 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 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 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, 2009 and 2008 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Beginning accrued warranty and related costs	$ 1,463	$ 996	$ 1,640	$ 1,030
Charged to cost of revenue	242	379	318	408
Actual warranty expenditures	(210))	(66)	(463)	(129)
Ending accrued warranty and related costs	$ 1,495	$ 1,309	$ 1,495	$ 1,309

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. Our purchase agreement to purchase eighteen thousand kilograms of gallium from Recapture Metals expired on December 31, 2008. As of June 30, 2009, we do not have any material purchase obligations.

Note 12. Foreign Exchange Transaction Gains/Losses

We incurred foreign currency transaction exchange gains of $183,000 and foreign currency transaction exchange losses of $593,000 for the three month periods ended June 30, 2009, and 2008, respectively. We incurred foreign currency transaction exchange losses of $253,000 and $404,000 for the six month periods ended June 30, 2009, and 2008, respectively. These amounts are included in Other income (expense), net on the condensed consolidated statements of operations.

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Note 13. Income Taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN48), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109)* (SFAS 109). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109. 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. FIN 48 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 FIN 48 effective January 1, 2007. We recognize interest and penalties related to uncertain tax positions in income tax expense. As of March 31, 2009, 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 FIN 48, 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, 2007.

Note 14. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The statement became effective for financial statements issued for years beginning after November 15, 2007 and interim periods within that year. On February 12, 2008 the FASB issued FASB Staff Position (FSP) FAS 157-2. This FSP permits a delay in the effective date of SFAS 157 to years beginning after November 15, 2008, for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the Board and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS 157. On February 14, 2008, the FASB issued FSP FAS 157-1 to exclude SFAS 13, Accounting for Leases, and its related interpretive accounting pronouncements from the scope of SFAS 157. We adopted this statement for financial assets and financial liabilities and nonfinancial assets and nonfinancial liabilities disclosed or recognized at fair value on a recurring basis (at least annually) as of January 1, 2008. We adopted the statement for nonfinancial assets and nonfinancial liabilities on January 1, 2009. The adoption of this statement in each period did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* , (SFAS 141R). SFAS 141R establishes the principles and requirements for how an acquirer in a business combination (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree, (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) will be applicable beginning with our fiscal 2009. We adopted this statement January 1, 2009. There was no impact upon adoption of on our consolidated financial statements and its effects on future periods will depend on the nature and extent of business combinations that we complete, if any, in or after fiscal 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 requires that minority interest be separately reported in the consolidated entity s equity section and that no gain or loss shall be reported when transactions occur between the controlling interest and the non-controlling interests. Furthermore, the acquisition of non-controlling interest by the controlling interest is not treated as a business combination. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We adopted this statement on January 1, 2009. The presentation and disclosures required of SFAS 160, which must be applied retrospectively for all periods presented, have resulted in reclassifications to our prior period consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 requires companies with derivative instruments to disclose information that should enable financial-statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We have determined that there is no impact from adopting this statement on our consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position (FSP) Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in FSP EITF 03-6-1. Early application of FSP EITF 03-6-1 is prohibited. We have determined that there is no impact from adopting this statement on our consolidated financial statements.

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In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. This FSP requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS No. 5, Accounting for Contingencies and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss. Further, the FASB removed the subsequent accounting guidance for assets and liabilities arising from contingencies from SFAS No. 141(R). The requirements of this FSP carry forward without significant revision the guidance on contingencies of SFAS No. 141, Business Combinations, which was superseded by SFAS No. 141(R). The FSP also eliminates the requirement to disclose an estimate of the range of possible outcomes of recognized contingencies at the acquisition date. For unrecognized contingencies, the FASB requires that entities include only the disclosures required by SFAS No. 5. SFAS 141(R), as modified by FSP 141(R)-1, is required to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS 141(R), as modified by FSP 141(R)-1, as of January 1, 2009 had no impact on our consolidated financial statements and its effects on future periods will depend on the nature and extent of business combinations that we complete, if any, in or after fiscal 2009.

In April 2009, the FASB issued the three new accounting standards which are required to be adopted no later than periods ending after June 15, 2009. We are currently evaluating the impact of the following:

i.) FASB Staff Position FAS 157-4, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* (FSP FAS 157-4) provides guidelines for making fair value measurements more consistent with the principles presented in SFAS 157. FSP FAS 157-4 provides additional authoritative guidance in determining whether a market is active or inactive, and whether a transaction is distressed, is applicable to all assets and liabilities (i.e. financial and nonfinancial) and will require enhanced disclosures.

ii.) FASB Staff Position FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* provides additional guidance to provide greater clarity about the credit and noncredit component of an other-than-temporary impairment event and to improve presentation and disclosure of other than temporary impairments in the financial statements.

iii.) FASB Staff Position FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments in interim as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in all interim financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), which provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS 165 is effective for interim and annual periods ending after June 15, 2009 and is to be applied prospectively. Accordingly, we adopted the provisions of SFAS 165 in the second quarter of 2009 and it did not have a material impact on our consolidated financial statements. Refer to Note 15 for our disclosure on subsequent events.

In June 2009, the FASB approved the *FASB Accounting Standards Codification* (the Codification) as the single source of authoritative nongovernmental U.S. GAAP to be launched on July 1, 2009. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. All existing

accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered nonauthoritative. The Codification is effective for interim and annual periods ending after September 15, 2009. The Codification is effective for the Company in the interim period ending September 30, 2009 and the Company does not expect the adoption to have a material impact on its consolidated financial position, results of operations or cash flows.

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.

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Note 15. Subsequent Event

On July 20, 2009, we announced the appointment of Dr. Morris S. Young as Chief Executive Officer, effective July 16, 2009. Dr. Young fills the vacancy created by the March 2009 departure of Dr. Philip C.S. Yin as the Company s chief executive officer. Dr. Young continues to serve as a member of the Board of Directors of the Company but will no longer be eligible for compensation for his services as a director but instead will be paid compensation as disclosed on the Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on July 20, 2009.

In accordance with SFAS No. 165, *Subsequent Events,* we have evaluated subsequent events through the date that the consolidated financial statements were filed with the Securities and Exchange Commission on August 10, 2009. No events have taken place, other than the appointment of Dr. Morris S. Young as chief executive officer, that meet the definition of a subsequent event that require disclosure in this filing.

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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, improvements in our product quality, our ability to expand our markets and increase sales, customer qualifications of our products, gross margins, favorable pricing, reliable supply and enhanced sourcing lead-times of raw materials, and our reserve balances. 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 fu 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, 2008 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:

Product Substrates	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	• 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 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 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. However, the economic downturn that began in 2008, coupled with inventory overhang in the industry put pressure on our financial performance in 2008 and has continued to have an impact on our results in 2009.

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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, coupled with our competitive manufacturing and cost advantages give us confidence in our ability to continue to drive future business in 2009. Following very challenging industry conditions early in the year, we are pleased to report that the improvements we began to see at the end of the first quarter continued through the second quarter, resulting in stronger sales and improved gross margins. We believe that inventory levels in the supply chain have improved from the first quarter, with the exception of our gallium raw materials, which are not expected to begin to recover until later in 2009. Our qualification efforts in both gallium arsenide and germanium substrates have been very successful and we are pleased with our increasing diversification in these areas.

As of June 30, 2009, our principal sources of liquidity were $30.6 million in cash and cash equivalents and short-term investments, excluding restricted deposits. Cash and cash equivalents and short-term investments of $30.6 million increased by $1.1 million in the second quarter of 2009 compared to the first quarter of 2009.

On July 20, 2009, we announced the appointment of Dr. Morris S. Young as Chief Executive Officer, effective July 16, 2009. Dr. Young fills the vacancy created by the March 2009 departure of Dr. Philip C.S. Yin as the Company s chief executive officer. Dr. Young continues to serve as a member of the Board of Directors of the Company.

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 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. Additionally, 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.

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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.

As of June 30, 2009 and December 31, 2008, our accounts receivable, net, balance was $12.9 million and $11.5 million, respectively, which was net of an allowance for doubtful accounts of $358,000 and $663,000, 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.

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, 2009 and December 31, 2008, accrued product warranties totaled $1.5 million and $1.6 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 each of June 30, 2009 and December 31, 2008, we had an inventory reserve of $12.5 million and $12.0 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 Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in 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.

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. SFAS No. 157 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, 2009, 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 SFAS No. 144, *Accounting for the Impairment or 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 SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), 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 SFAS 123, *Accounting for Stock-Based Compensation.* 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 SFAS No. 109 (SFAS 109), *Accounting for Income Taxes,* 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. SFAS 109 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.

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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 FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. See Note 13 Income Taxes in the condensed financial statements for additional information.

Results of Operations

Revenue

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
GaAs	$ 10,108	$ 13,142	$ (3,034)	(23.1)%
InP	684	500	184	36.8%
Ge	1,217	1,384	(167)	(12.1)%
Raw materials and other	1,046	4,906	(3,860)	(78.7)%
Total revenue	$ 13,055	$ 19,932	$ (6,877)	(34.5)%

Revenue decreased $6.9 million, or 34.5%, to $13.1 million for the three months ended June 30, 2009 from $19.9 million for the three months ended June 30, 2008. Total GaAs substrate revenue decreased $3.0 million, or 23.1%, to $10.1 million for the three months ended June 30, 2009 from $13.1 million for the three months ended June 30, 2008. The decline in revenue was primarily due to the overall weaker demand environment and inventory overhang, affecting sales of all diameters.

Sales of 5 inch and 6 inch diameter GaAs substrates were $4.4 million for the three months ended June 30, 2009 compared to $6.1 million for the three months ended June 30, 2008. Despite our renewed supply agreement with IQE plc for 2009, the demand from their end customers also dropped due to the worldwide economic slowdown causing IQE as well as our other customers to temporarily utilize their excess inventory. However, under our agreement with IQE, they have agreed to purchase from us a minimum of approximately $14.3 million of GaAs substrates through March 2010 and accordingly we expect demand from IQE group will increase in the latter half of 2009.

Sales of 2 inch, 3 inch and 4 inch diameter GaAs substrates were $5.7 million for the three months ended June 30, 2009 compared with $7.1 million for the three months ended June 30, 2008. Similar to the larger diameter substrate customers, the decrease in revenue from smaller diameter substrates was due to the drop in demand from our LED semi-conducting customers while they continue to utilize their excess inventory.

InP substrate revenue increased $0.2 million, or 36.8%, to $684,000 for the three months ended June 30, 2009 from $500,000 for the three months ended June 30, 2008 as demand from customers in the optical networking industry has remained steady.

Ge substrate revenue decreased $0.2 million, or 12.1%, to $1.2 for the three months ended June 30, 2009 from $1.4 million for the three months ended June 30, 2008. While our Ge substrate revenue has dropped in the first quarter of 2009, our newly qualified European customer began to release full production orders during the second quarter of 2009 for concentrated photovoltaic solar applications.

Raw materials revenue decreased $3.9 million, or 78.7%, to $1.0 million for the three months ended June 30, 2009 from $4.9 million for the three months ended June 30, 2008. The decrease in raw materials revenue was primarily due to the worldwide drop in demand for 4N gallium. In particular, our China joint venture Jiya has experienced the impact of the slowdown causing their customers to postpone or cancel orders while utilizing excess inventory.

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	Six Months Ended June 30, 2009	2008	Increase (Decrease)	% Change
		($ in thousands)		
GaAs	$ 15,120	$ 26,862	$ (11,742)	(43.7)%
InP	1,174	978	196	20.0%
Ge	1,839	2,769	(930)	(33.6)%
Raw materials and other	2,576	8,957	(6,381)	(71.2)%
Total revenue	$ 20,709	$ 39,566	$ (18,857)	(47.7)%

Revenue decreased $18.9 million, or 47.7%, to $20.7 million for the six months ended June 30, 2009 from $39.6 million for the six months ended June 30, 2008. Total GaAs substrate revenue decreased $11.7 million, or 43.7%, to $15.1 million for the six months ended June 30, 2009 from $26.9 million for the six months ended June 30, 2008. The decline in revenue was primarily due to the overall weaker demand environment and inventory overhang, affecting sales of all diameters.

Sales of 5 inch and 6 inch diameter GaAs substrates were $5.7 million for the six months ended June 30, 2009 compared to $12.9 million for the six months ended June 30, 2008. Despite our renewed supply agreement with IQE plc for 2009, the demand from their end customers also dropped due to the worldwide economic slowdown causing IQE as well as our other customers to temporarily utilize their excess inventory. However, under our agreement with IQE, they have agreed to purchase from us a minimum of approximately $14.3 million of GaAs substrates through March 2010 and accordingly we expect demand from IQE group will increase in the latter half of 2009.

Sales of 2 inch, 3 inch and 4 inch diameter GaAs substrates were $9.5 million for the six months ended June 30, 2009 compared with $13.9 million for the six months ended June 30, 2008. Similar to the larger diameter substrate customers, the decrease in revenue from smaller diameter substrates was due to the drop in demand from our LED semi-conducting customers while they continue to utilize their excess inventory.

InP substrate revenue increased $0.2 million, or 20.0%, to $1.2 million for the six months ended June 30, 2009 from $1.0 million for the six months ended June 30, 2008 as demand from customers in the optical networking industry has remained steady.

Ge substrate revenue decreased $0.9 million, or 33.6%, to $1.8 for the six months ended June 30, 2009 from $2.8 million for the six months ended June 30, 2008. While our Ge substrate revenue has dropped in the first quarter of 2009, our newly qualified European customer began to release full production orders during the second quarter of 2009 for concentrated photovoltaic solar applications.

Raw materials revenue decreased $6.4 million, or 71.2%, to $2.6 million for the six months ended June 30, 2009 from $9.0 million for the six months ended June 30, 2008. The decrease in raw materials revenue was primarily due to the worldwide drop in demand for 4N gallium. In particular, our China joint venture Jiya has experienced the impact of the slowdown causing their customers to postpone or cancel orders while utilizing excess inventory.

Revenue by Geographic Region

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
North America *	$ 2,428	$ 5,437	$ (3,009)	(55.3)%
% of total revenue	19%	27%		
Europe	2,264	3,966	(1,702)	(42.9)%
% of total revenue	17%	20%		
Japan	2,038	4,595	(2,557)	(55.6)%
% of total revenue	16%	23%		
Taiwan	2,746	2,061	685	33.2%
% of total revenue	21%	10%		
Asia Pacific (excluding Japan and Taiwan)	3,579	3,873	(294)	(7.6)%
% of total revenue	27%	20%		
Total revenue	$ 13,055	$ 19,932	$ (6,877)	(34.5)%

*Primarily the United States

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Revenue from customers in North America decreased by $3.0 million, or 55.3%, to $2.4 million for the three months ended June 30, 2009 from $5.4 million for the three months ended June 30, 2008 as the demand for substrates fell by $2.4 million while the demand for raw materials fell by $0.6 million. We expect our North America revenue to increase in the latter part of 2009 based upon a renewed supply agreement we signed in the fourth quarter of 2008 with IQE plc. Under the terms of the agreement, IQE plc has agreed to purchase from us a minimum of approximately $14.3 million of 4-inch and 6-inch semi-insulating gallium arsenide (GaAs) substrates. All substrates ordered pursuant to the agreement are to be shipped by the end of March 2010.

Revenue from customers in Europe decreased by $1.7 million, or 42.9%, to $2.3 million for the three months ended June 30, 2009 from $4.0 million for the three months ended June 30, 2008. This decrease came primarily from decreased raw material sales of $0.9 million to customers in The Netherlands, and decreased substrate sales to customers in Germany of $0.6 million and to customers in France of $0.2 million due to decreased demand.

Revenue from customers in Japan decreased by $2.6 million, or 55.6%, to $2.0 million for the three months ended June 30, 2009 from $4.6 million for the three months ended June 30, 2008. Raw material sales of 4N gallium decreased by $2.1 million as demand fell while substrate sales decreased by $0.5 million, particularly in large diameter wafers.

Revenue from customers in Taiwan increased by $0.7 million, or 33.2%, to $2.7 million for the three months ended June 30, 2009 from $2.0 million for the three months ended June 30, 2008. The increase came mainly from three existing customers for small diameter wafers used in the LED market.

Revenue from customers in Asia Pacific (excluding Japan and Taiwan) decreased by $0.3 million, or 7.6%, to $3.6 million for the three months ended June 30, 2009 from $3.9 million for the three months ended June 30, 2008. Sales to customers in China decreased by $0.8 million, which was partially offset by increased sales of $0.5 million to customers in Singapore, one of which is part of the IQE group.

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
North America *	$ 4,164	$ 10,436	$ (6,272)	(60.1)%
% of total revenue	20%	26%		
Europe	4,477	6,783	(2,306)	(34.0)%
% of total revenue	22%	17%		
Japan	3,190	8,735	(5,545)	(63.5)%
% of total revenue	15%	22%		
Taiwan	3,435	4,868	(1,433)	(29.4)%
% of total revenue	17%	12%		
Asia Pacific (excluding Japan and Taiwan)	5,443	8,744	(3,301)	(37.8)%
% of total revenue	26%	22%		
Total revenue	$ 20,709	$ 39,566	$ (18,857)	(47.7)%

*Primarily the United States

Revenue from customers in North America decreased by $6.3 million, or 60.1%, to $4.2 million for the six months ended June 30, 2009 from $10.4 million for the six months ended June 30, 2008 as the demand for substrates fell by $4.6 million while the demand for raw materials fell by $1.7 million. We expect our North America revenue to increase in the latter part of 2009 based upon a renewed supply agreement we signed in the fourth quarter of 2008 with IQE plc. Under the terms of the agreement, IQE plc has agreed to purchase from us a minimum of approximately $14.3 million of 4-inch and 6-inch semi-insulating gallium arsenide (GaAs) substrates. All substrates ordered pursuant to the agreement are to be shipped by the end of March 2010.

Revenue from customers in Europe decreased by $2.3 million, or 34.0%, to $4.5 million for the six months ended June 30, 2009 from $6.8 million for the six months ended June 30, 2008. This decrease came primarily from decreased raw material sales of $1.0 million to customers in The Netherlands, and decreased substrate sales to customers in Germany of $1.0 million and to customers in France of $1.0 million due to decreased demand, partially offset by increased demand from customers in the United Kingdom of $0.6 million, one of which is part of the IQE group with whom we renewed a supply agreement in the fourth quarter of 2008. Substrate sales to other customers in Europe decreased by $0.1 million.

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Revenue from customers in Japan decreased by $5.5 million, or 63.5%, to $3.2 million for the six months ended June 30, 2009 from $8.7 million for the six months ended June 30, 2008. Raw material sales of 4N gallium decreased by $3.5 million as demand fell while substrate sales decreased by $2.0 million, particularly in large diameter wafers.

Revenue from customers in Taiwan decreased by $1.4 million, or 29.4%, to $3.4 million for the six months ended June 30, 2009 from $4.9 million for the six months ended June 30, 2008. The decrease came mainly from one major existing customer for large diameter wafers due to a fall in demand.

Revenue from customers in Asia Pacific (excluding Japan and Taiwan) decreased by $3.3 million, or 37.8%, to $5.4 million for the six months ended June 30, 2009 from $8.7 million for the six months ended June 30, 2008. Decrease in demand caused sales to customers in China to decrease by $2.9 million, sales to customers in Singapore to decrease by $0.2 million, and sales to customers in Korea to decrease by $0.1 million.

Gross Margin

	Three Months Ended June 30,			
	2009	**2008**	**Increase (Decrease)**	**% Change**
	($ in thousands)			
Gross profit	$ 2,516	$ 6,444	$ (3,928)	(60.9)%
Gross Margin %	19.3%	32.3%		

Gross margin decreased to 19.3% of total revenue for the three months ended June 30, 2009 from 32.3% of total revenue for the three months ended June 30, 2008. Gross margins in the three months ended June 30, 2009 and 2008 were positively impacted by sales of approximately $633,000 and $735,000, respectively, of GaAs wafers that were previously fully reserved. The 19.3 percent gross margin for the three months ended June 30, 2009 was primarily due to the lower absorption rates as a result of reduced sales from the fourth quarter of 2008, and hence lower production volume. Since late 2008, our gallium joint venture in China also continued to source finished products from an independent third party supplier, resulting in low gross margin. Our gallium joint venture continues to discuss with this third party supplier an agreement to purchase and distribute a certain amount of its product on an ongoing basis, in amounts representing up to 50% of our joint venture s total customer commitments. This third-party provider has a substantial share of the available gallium and is interested in partnering with our joint venture in order to leverage its distribution capabilities. Although this potential partnership would provide additional capacity to our joint venture and increase its competitive position, should an agreement be formalized, our raw materials gross margin would be negatively impacted. In addition, gross margins were negatively impacted by declining average selling prices and rising raw material costs, as well as an increase in depreciation as a result of our purchase of equipment acquired for our capacity expansion.

Conversely, product mix contributed to higher gross profit for the three months ended June 30, 2008 as we sold a greater amount of larger diameter substrates which contributed higher gross profit and during the three months ended June 30, 2008, our manufacturing facility in Beijing was operating at almost full capacity, which resulted in higher absorption rates.

	Six Months Ended June 30,		Increase

	2009	2008	(Decrease)	% Change
	($ in thousands)			
Gross profit	$ 2,279	$ 12,665	$ (10,386)	(82.0)%
Gross Margin %	11.0%	32.0%		

Gross margin decreased to 11.0% of total revenue for the six months ended June 30, 2009 from 32.0% of total revenue for the six months ended June 30, 2008. Gross margins in the six months ended June 30, 2009 and 2008 were positively impacted by sales of approximately $1.0 million and $1.4 million, respectively, of GaAs wafers that were previously fully reserved. The 11.0 percent gross margin for the six months ended June 30, 2009 was primarily due to the lower absorption rates as a result of reduced sales from the fourth quarter of 2008, and hence lower production volume. Since late 2008, our gallium joint venture in China also continued to source finished products from an independent third party supplier, resulting in low gross margin. Our gallium joint venture continues to discuss with this third party supplier an agreement to purchase and distribute a certain amount of its product on an ongoing basis, in amounts representing up to 50% of our joint venture s total customer commitments. This third-party provider has a substantial share of the available gallium and is interested in partnering with our joint venture in order to leverage its distribution capabilities. Although this potential partnership would provide additional capacity to our joint venture and increase its competitive position, should an agreement be formalized, our raw materials gross margin would be negatively impacted. In addition, gross margins were negatively impacted by declining average selling prices and rising raw material costs, as well as an increase in depreciation as a result of our purchase of equipment acquired for our capacity expansion.

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Conversely, product mix contributed to higher gross profit for the six months ended June 30, 2008 as we sold a greater amount of larger diameter substrates which contributed higher gross profit and during the six months ended June 30, 2008, our manufacturing facility in Beijing was operating at almost full capacity, which resulted in higher absorption rates.

Selling, General and Administrative Expenses

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Selling, general and administrative expenses	$ 3,486	$ 3,578	$ (92)	(2.6)%
% of total revenue	26.7%	18.0%		

Selling, general and administrative expenses decreased $0.1 million, or 2.6%, to $3.5 million for the three months ended June 30, 2009 from $3.6 million for the three months ended June 30, 2008. The decrease was from $0.2 million lower health insurance costs in China due to a national refund received, $0.2 million from the absence of bonus accruals in 2009, $0.1 million less rent expense at our Fremont, CA facility, $0.1 million less travel expenses from cost cutting and from no travel by our former CEO, partially offset by $0.3 million accrued employee-related expenses, $0.2 million increase in bad debt allowance as we provide for a slow paying U. S. customer.

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Selling, general and administrative expenses	$ 7,492	$ 7,245	$ 247	3.4%
% of total revenue	36.2%	18.3%		

Selling, general and administrative expenses increased $0.3 million, or 3.4%, to $7.5 million for the six months ended June 30, 2009 from $7.2 million for the six months ended June 30, 2008. The increase was from $0.6 million increased legal fees as a result of matters relating to the change in management in March 2009, $0.3 million severance pay for our former chief executive officer, $0.3 million in related stock compensation expense for his stock option acceleration, and $0.3 million accrued employee-related expenses, partially offset by $0.4 million from the absence of bonus accruals in 2009, $0.3 million less rent expense at our Fremont, CA facility, $0.2 million less travel expenses from cost cutting and from no travel by our former CEO, $0.1 million less sales commissions due to reduced sales volume, $0.1 million lower health insurance costs in China due to a national refund received, and $0.1 million less labor costs in our joint ventures, mainly from the absence of bonus accruals beginning in 2009.

Research and Development

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Research and development	$ 355	$ 569	$ (214)	(37.6)%
% of total revenue	2.7%	2.9%		

Research and development expenses decreased $0.2 million, or 37.6% to $0.4 million for the three months ended June 30, 2009 from $0.6 million for the three months ended June 30, 2008. The decrease was primarily due to $0.1 million less labor costs as a result of our restructuring in March 2009 and the absence of bonus accruals beginning in 2009, and $0.1 million less outside consulting costs.

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Research and development	$ 815	$ 1,073	$ (258)	(24.0)%
% of total revenue	3.9%	2.7%		

Research and development expenses decreased $0.3 million, or 24.0%, to $0.8 million for the six months ended June 30, 2009 from $1.1 million for the six months ended June 30, 2008. The decrease was primarily due to $0.2 million less labor costs as a result of our restructuring in March 2009 and the absence of bonus accruals beginning in 2009, and $0.1 million less outside consulting costs.

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Impairment (Recovery) on Assets Held For Sale

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Impairment (Recovery) on assets held for sale	$	$ 83	$ (83)	NM
% of total revenue	0.0%	0.2%		

NM = % not meaningful

During the first quarter of 2008, we completed the sale of our property in Fremont, California. The escrow established to pay the purchase price of the property closed on March 28, 2008. The final purchase price for the property was $5.3 million. We received net proceeds of $5.1 million after deducting commissions and selling expenses. We recorded an impairment charge upon the sale of the property of $83,000. There was no impairment charge for the three and six month periods ended June 30, 2009.

Restructuring Charge

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Restructuring charge	$ 507	$	$ 507	NM
% of total revenue	2.4%	0.0%		

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 are 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 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 2008.

Interest Income, net

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Interest income, net	$ 34	$ 241	$ (207)	(85.9)%
% of total revenue	0.3%	1.2%		

Interest income, net decreased $0.2 million to $34,000 for the three months ended June 30, 2009 from $0.2 million for the three months ended June 30, 2008. Interest income, net for the three months ended June 30, 2009 was lower due to the overall lower balances of our cash and investments and with lower yields after we paid down on our taxable revenue bond in July 2008, while interest income, net for the three months ended June 30, 2008 had higher cash balances and with higher yields.

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Interest income, net	$ 78	$ 365	$ (287)	(78.6)%
% of total revenue	0.4%	0.9%		

Interest income, net decreased $0.3 million to $78,000 for the six months ended June 30, 2009 from $0.4 million for the six months ended June 30, 2008. Interest income, net for the six months ended June 30, 2009 was lower due to the overall lower balances of our cash and investments and with lower yields after we paid down on our taxable revenue bond in July 2008, while interest income, net for the six months ended June 30, 2008 had higher cash balances and with higher yields.

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Other Income (Loss), net

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Other income (loss), net	$ 321	$ (518)	$ 839	161.9%
% of total revenue	2.5%	(2.6)%		

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. Other loss, net was $518,000 for the three months ended June 30, 2008 primarily due to foreign exchange loss of $593,000, offset by investment income of $75,000 from the same minority-owned joint ventures that are not consolidated.

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Other income (loss), net	$ (101)	$ 409	$ (510)	(124.7)%
% of total revenue	(0.5)%	1.0%		

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. Other income, net was $409,000 for the six months ended June 30, 2008 primarily due to investment income of $0.5 million from the same minority-owned joint ventures that are not consolidated, and realized gain on sale of investments of $0.3 million, offset by foreign exchange losses of $0.4 million.

Noncontrolling interest

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Noncontrolling interest	$ (2)	$ (648)	$ 646	99.7%
% of total revenue	0.0%	(3.3)%		

NM = % not meaningful

Noncontrolling interest increased $0.6 million to $2,000 for the three months ended June 30, 2009 from $(0.6) million for the three months ended June 30, 2008 indicating less profitability from our China joint venture operations as raw materials sales have declined due to weaker demand environment causing our customers to continue to utilize their excess inventory.

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Noncontrolling interest	$ 74	$ (1,147)	$ 1,221	106.5%
% of total revenue	0.0%	(2.9)%		

Noncontrolling interest increased $1.2 million to $74,000 for the six months ended June 30, 2009 from $(1.1) million for the six months ended June 30, 2008 indicating less profitability from our China joint venture operations as raw materials sales have declined due to weaker demand environment causing our customers to continue to utilize their excess inventory.

Provision for Income Taxes

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Provision for income taxes	$ 308	$ 635	$ (327)	(51.5)%
% of total revenue	2.4%	3.2%		

We provided for income taxes of $0.3 million for our China operations for the three months ended June 30, 2009 compared to $0.6 million for the three months ended June 30, 2008. The decrease in tax provision was primarily due to our overall loss position for the first six months of 2009 compared to the same period last year. Beginning in 2008, the tax provision was calculated based on the assumption that we will no longer receive refunds for profit reinvestments in China.

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	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
	($ in thousands)			
Provision for income taxes	$ 312	$ 1,195	$ (883)	(73.9)%
% of total revenue	1.5%	3.0%		

We provided for income taxes of $0.3 million for our China operations for the six months ended June 30, 2009 compared to $1.2 million for the six months ended June 30, 2008. The decrease in tax provision was primarily due to our overall loss position for the first six months of 2009 compared to the same period last year. Beginning in 2008, the tax provision was calculated based on the assumption that we will no longer receive refunds for profit reinvestments in China.

Liquidity and Capital Resources

As of June 30, 2009, our principal sources of liquidity were $30.6 million in cash and cash equivalents and short-term investments, excluding restricted deposits. 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. All of our short-term investments in corporate bonds (see note 3) are invested in Citigroup guaranteed instruments.

Cash and cash equivalents and short-term investments of $30.6 million increased by $1.2 million in the second quarter of 2009 compared to the first quarter of 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 $6.8 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 $2.9 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 $1.1 million decrease in other long-term liabilities, a $0.4 million decrease in accrued liabilities, and a $0.1 million increase in other assets.

Accounts receivable, net increased by $1.4 million as of June 30, 2009 compared to December 31, 2008 due to higher sales volume. Our days sales outstanding (DSO) is 90 days as of June 30, 2009 and was 68 days as of December 31, 2008. Our DSO was lower in 2008 as we had higher raw material sales which have quicker collection cycles than our substrate sales.

Inventories, net, decreased by $6.8 million, as we decreased raw materials by $3.9 million as we held back on purchasing and consumed what we needed from existing inventory, and we decreased work-in-process and finished goods by $2.9 million as we shipped these out as sales. Inventories, net, increased by $13.6 million as of June 30, 2008, as we increased inventory in raw materials and work-in-process to increase production in anticipation of increased forecast sales, and finished goods for consignment orders.

Net cash used in operating activities of $4.5 million for the six months ended June 30, 2008 was primarily comprised of our net income of $2.7 million, adjusted for non-cash items of depreciation of $1.0 million, stock-based compensation of $0.3 million, partially offset by a realized gain on sale of investments of $0.3 million, and offset by a net increase of $8.2 million in assets and liabilities. The $8.2 million net increase in assets and liabilities primarily resulted from a $13.6 million increase in inventories, a $2.1 million increase in prepaid expenses, a $1.4 million increase in accounts receivable, $0.9 million decrease in other long-term liabilities, and a $0.4 million increase in other assets, partially offset by a $9.5 million increase in accounts payable, a $0.7 million increase in accrued liabilities.

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.

Net cash provided by investing activities of $5.0 million for the six months ended June 30, 2008 was primarily from the proceeds from the sale of investments of $14.5 million, proceeds from sale of assets held for sale of $5.1 million and the decrease of restricted cash of $0.3 million, partially offset by the purchase of investments totaling $11.7 million, and the purchase of property, plant and equipment, of $3.1 million.

We expect to invest up to approximately $4.8 million in capital projects at our China facilities for the remainder of 2009, having delayed certain expansion activities as a result of the impact of the current worldwide economic conditions.

Net cash used in financing activities of $9,000 for the six months ended June 30, 2009 consisted of payments of $49,000 related to our tenant improvement loan, partially offset by net proceeds of $40,000 on the issuance of common stock.

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Net cash used in financing activities of $139,000 for the six months ended June 30, 2008 consisted scheduled payments of $288,000 related to long-term borrowings, partially offset by $149,000 from the proceeds from the exercise of employee stock options.

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, 2009 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**
Line of credit	$ 3,000	$ 3,000	$	$	$
Tenant improvement loan	533	74	158	171	130
Operating leases	1,889	303	571	578	437
Total	$ 5,422	$ 3,377	$ 729	$ 749	$ 567

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 $0.1 million and $0.2 million for the three months ended June 30, 2009 and 2008, respectively.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The statement became effective for financial statements issued for years beginning after November 15, 2007 and interim periods within that year. On February 12, 2008 the FASB issued FASB Staff Position (FSP) FAS 157-2. This FSP permits a delay in the effective date of SFAS 157 to years beginning after November 15, 2008, for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the Board and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS 157. On February 14, 2008, the FASB issued FSP FAS 157-1 to exclude SFAS 13, Accounting for Leases, and its related interpretive accounting pronouncements from the scope of SFAS 157. We adopted this statement for financial assets and financial liabilities and nonfinancial assets and nonfinancial liabilities disclosed or recognized at fair value on a recurring basis (at least annually) as of January 1, 2008. We adopted the statement for nonfinancial assets and nonfinancial liabilities on January 1, 2009. The adoption of this statement in each period did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, (SFAS 141R). SFAS 141R establishes the principles and requirements for how an acquirer in a business combination (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree, (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) will be applicable beginning with our fiscal 2009. We adopted this statement January 1, 2009. There was no impact upon adoption of on our consolidated financial statements and its effects on future periods will depend on the nature and extent of business combinations that we complete, if any, in or after fiscal 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 requires that minority interest be separately reported in the consolidated entity s equity section and that no gain or loss shall be reported when transactions occur between the controlling interest and the non-controlling interests. Furthermore, the acquisition of non-controlling interest by the controlling interest is not treated as a business combination. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We adopted this statement on January 1, 2009. The presentation and disclosures required of SFAS 160, which must be applied retrospectively for all periods presented, have resulted in reclassifications to our prior period consolidated financial statements.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 requires companies with derivative instruments to disclose information that should enable financial-statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We have determined that there is no impact from adopting this statement on our consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position (FSP) Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in FSP EITF 03-6-1. Early application of FSP EITF 03-6-1 is prohibited. We have determined that there is no impact from adopting this statement on our consolidated financial statements.

In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. This FSP requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS No. 5, Accounting for Contingencies and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss . Further, the FASB removed the subsequent accounting guidance for assets and liabilities arising from contingencies from SFAS No. 141(R). The requirements of this FSP carry forward without significant revision the guidance on contingencies of SFAS No. 141, Business Combinations , which was superseded by SFAS No. 141(R). The FSP also eliminates the requirement to disclose an estimate of the range of possible outcomes of recognized contingencies at the acquisition date. For unrecognized contingencies, the FASB requires that entities include only the disclosures required by SFAS No. 5. SFAS 141(R), as modified by FSP 141(R)-1, is required to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS 141(R), as modified by FSP 141(R)-1, as of January 1, 2009 had no impact on our consolidated financial statements and its effects on future periods will depend on the nature and extent of business combinations that we complete, if any, in or after fiscal 2009.

In April 2009, the FASB issued the three new accounting standards which are required to be adopted no later than periods ending after June 15, 2009. We are currently evaluating the impact of the following:

i.) FASB Staff Position FAS 157-4, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* (FSP FAS 157-4) provides guidelines for making fair value measurements more consistent with the principles presented in SFAS 157. FSP FAS 157-4 provides additional authoritative guidance in determining whether a market is active or inactive, and whether a transaction is distressed, is applicable to all assets and liabilities (i.e. financial and nonfinancial) and will require enhanced disclosures.

ii.) FASB Staff Position FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* provides additional guidance to provide greater clarity about the credit and noncredit component of an other-than-temporary impairment event and to improve presentation and disclosure of other than temporary impairments in the financial statements.

iii.) FASB Staff Position FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments , to require disclosures about fair value of financial instruments in interim as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in all interim financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), which provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS 165 is effective for interim and annual periods ending after June 15, 2009 and is to be applied prospectively. Accordingly, we adopted the provisions of SFAS 165 in the second quarter of 2009 and it did not have a material impact on our consolidated financial statements. Refer to Note 15 for our disclosure on subsequent events.

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In June 2009, the FASB approved the *FASB Accounting Standards Codification* (the Codification) as the single source of authoritative nongovernmental U.S. GAAP to be launched on July 1, 2009. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. All existing accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered nonauthoritative. The Codification is effective for interim and annual periods ending after September 15, 2009. The Codification is effective for the Company in the interim period ending September 30, 2009 and the Company does not expect the adoption to have a material impact on its consolidated financial position, results of operations or cash flows.

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, 2009, we had no outstanding commitments with respect to foreign exchange contracts.

During the second quarter of 2009, we recorded a net realized foreign exchange gain of $183,000, 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 2009, we recorded unrealized foreign currency gain of $0.4 million, 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 reserve diversification 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 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.

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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, 2009	Current Interest Rate	Projected Annual Interest Income/(Expense)	Proforma 10% Interest Rate Decline Income/(Expense)	Proforma 10% Interest Rate Increase Income/(Expense)
Cash	$ 11,807	0.50%	$ 59	$ 53	$ 65
Cash equivalents	606	1.50	9	8	10
Investment in debt and equity instruments	21,216	5.13	1,088	980	1,197
Line of credit	(3,000)	1.57	(47)	(42)	(52)
Tenant improvement loan	(533)	4.00	(21)	(19)	(23)
			$ 1,088	$ 980	$ 1,197

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 Smith Barney. We have no investments in auction rate securities. As of June 30, 2009, we have approximately $21.0 million in principal protected notes with Citicorp Smith Barney with a fair value of approximately $21.0 million. We expect to decrease our exposure to Citicorp Smith Barney as these principal protected notes come due and the underlying assets are placed into diversified securities.

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, 2009 at 27%, and 17%, 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, 2009, the minority investments totaled $0.4 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.

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Changes in Internal Control Over Financial Reporting

During the quarter ended June 30, 2009, we completed the following changes in our internal control over financial reporting, or in other factors, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting:

On July 20, 2009, the Company announced the appointment of Dr. Morris S. Young as Chief Executive Officer, effective July 16, 2009. Dr. Young fills the vacancy created by the March 2009 departure of Dr. Philip C.S. Yin as the Company s chief executive officer. As a result of Dr. Young s appointment, Wilson W. Cheung, the Company s Chief Financial Officer, is no longer performing the functions of principal executive officer, but remains as Chief Financial Officer of the Company.

Subsequent to the completion of the quarter, we implemented further controls relating to employee business expenses, corporate gifts and business entertaining, and business development activities in connection with our ongoing effort to improve our control processes and corporate governance, and to monitor compliance with applicable rules and regulations. We expect to conduct additional training for our employees in August 2009 concerning matters relating to understanding of and compliance with our code of conduct, our process for reporting matters to our audit committee, and compliance with applicable rules and regulations.

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.

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, 2008.

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

None

Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

AXT held its annual meeting of stockholders at its headquarters in Fremont, California on May 26, 2009. Of the 31,052,393 shares outstanding as of the record date, 24,120,481 shares were represented in person or by proxy at the meeting. Proxies were solicited by the Company pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended. At the meeting, AXT s stockholders voted on the following matters:

(1) Proposal to elect one class II director to hold office for a three-year term, and until his successor is elected and qualified.

Class II director	For	Abstain
Jesse Chen	22,577,813	1,542,668

In addition, the term of office as directors of Dr. Morris S. Young, Dr. David C. Chang and Mr. Leonard LeBlanc continued after the meeting.

(2) Proposal to ratify the appointment of Burr, Pilger & Mayer LLP as independent registered public accounting firm for the fiscal year ending December 31, 2009.

	For	Against	Abstain
Burr, Pilger & Mayer LLP	23,909,428	133,263	77,790

Accordingly, both proposals were approved by the stockholders.

Item 5. Other Information

None

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Item 6. Exhibits

a. Exhibits

Exhibit Number	Description
3.1(1)	Restated Certificate of Incorporation
3.2(2)	Certificate of Designation, Preferences and Rights of Series A Preferred Stock.
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.
10.33(5)	Separation Agreement and General Release of Claims between AXT, Inc. and Philip C.S. Yin.
10.34(6)	Offer Letter dated July 16, 2009 between AXT, Inc. and Dr. Morris S. Young.
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 the exhibit of the same number as filed with the SEC in our Form 8-K on April 20, 2009.

(6) Incorporated by reference to Exhibit 99.1 to our Form 8-K as filed with the SEC on July 20, 2009.

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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 10, 2009

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

/s/ WILSON W. CHEUNG
Wilson W. Cheung
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description
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.
10.33(5)	Separation Agreement and General Release of Claims between AXT, Inc. and Philip C.S. Yin.
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