AXT INC
Form 10-Q
August 09, 2010
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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, 2010

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 o
Non-accelerated filer x (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 23, 2010
Common Stock, $0.001 par value	31,024,198

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AXT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

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

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

See accompanying notes to condensed consolidated financial statements.

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

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AXT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

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

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

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

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements of AXT, Inc. (AXT, the Company, we, us, and our refer to AXT, Inc. and 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 consolidated subsidiaries for all periods presented.

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

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

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

Note 2. Accounting for Stock-Based Compensation

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

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

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

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

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

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

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

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

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

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

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

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

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

Restricted stock awards

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

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

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

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

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

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

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

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Investments in Privately-held Companies

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

Fair Value Measurements

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

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

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

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

Items Measured at Fair Value on a Nonrecurring Basis

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

Note 4. Inventories, Net

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

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

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Note 5. Restructuring Charge

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

Note 6. Net Income (Loss) Per Share

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

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

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

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

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Note 7. Stockholders Equity and Other Comprehensive Income (Loss)

Consolidated Statements of Changes in Equity

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

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

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

Note 8. Segment Information and Foreign Operations

Segment Information

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

Product Information

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

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

*Primarily the United States

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

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

Significant Customers

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

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

Note 9. Investments in Privately-held Companies

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

Our investments are summarized below (in thousands):

Company	Investment Balance as of June 30, 2010	Investment Balance as of December 31, 2009	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%
	$ 1,998	$ 1,998		
Xilingol Tongli Germanium Co. Ltd	$ 3,355	$ 3,367	Equity	25%
Emeishan Jia Mei High Purity Metals Co., Ltd	959	866	Equity	25%
	$ 4,314	$ 4,233		

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

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

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

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

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

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

During the three and six months ended June 30, 2010 the three consolidated joint ventures had income of $1.3 million and $1.8 million of which $0.4 million and $0.5 million, respectively, was allocated to minority interests, resulting in income of $0.9 million and $1.3 million, respectively, included in our net income. During the three and six months ended June 30, 2009 the three consolidated joint ventures had $83,000 of income and a loss of $167,000 of which $2,000 and a loss of $74,000 was allocated to minority interests, resulting in income of $81,000 and a loss of $93,000.included in our net loss. Our equity earnings from the two-minority owned joint ventures that are not consolidated are recorded as other income (loss), net and totaled $82,000 and $139,000 for the six months ended June 30, 2010 and 2009, respectively. Undistributed retained earnings relating to all our investments in these companies were $13.8 million and $12.4 million as of June 30, 2010 and December 31, 2009, respectively.

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

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

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

Note 10. Commitments and Contingencies

Indemnification Agreements

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

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

Product Warranty

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

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

Ending accrued warranty and related costs	$ 880	$ 1,495	$ 880	$ 1,495

Purchase Obligations

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

Legal Proceedings

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

Note 11. Foreign Exchange Transaction Gains/Losses

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

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Note 12. Income Taxes

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

Note 13. Recent Accounting Pronouncements

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

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

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

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

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

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

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

Overview

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

Substrates	Product Diameter	Applications
GaAs (semi-insulating)	2 , 3 , 4 , 5 , 6	• 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

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

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

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

Critical Accounting Policies and Estimates

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

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

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

Revenue Recognition

We manufacture and sell high-performance compound semiconductor substrates and sell certain raw materials including gallium, germanium dioxide, and pBN crucibles. After we ship our products, there are no remaining obligations or customer acceptance requirements that would preclude revenue recognition. Our products are typically sold pursuant to a purchase order placed by our customers, and our terms and conditions of sale do not require customer acceptance. We recognize revenue upon shipment and transfer of title of products to our customers, which is either upon shipment from our dock, receipt at the customer s dock, or removal from consignment inventory at the customer s location, provided that we have received a signed purchase order, the price is fixed or determinable, title and risk of ownership have transferred, collection of resulting receivables is probable, and product returns are reasonably estimable. We do not provide training, installation or commissioning services. We may provide discounts or other incentives to customers in order to secure business.

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

Accounts Receivable and Allowance for Doubtful Accounts

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

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

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

Warranty Reserve

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

Inventory Valuation

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

Impairment of Investments

We classify our investments in debt and equity securities as available-for-sale securities as prescribed by ASC topic 320, *Debt and Equity Securities.* All available-for-sale securities with a quoted market value below cost (or adjusted cost) are reviewed in order to determine whether the decline is other-than-temporary. Factors considered in determining wheth