AXT INC
Form 10-Q
August 11, 2008

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, 2008

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 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, 2008**
Common Stock, $0.001 par value	30,435,403

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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, 2008	December 31, 2007
Assets:		
Current assets:		
Cash and cash equivalents	$ 19,292	$ 18,380
Short-term investments	17,698	20,825
Accounts receivable, net of allowances of $126 and $379 as of June 30, 2008 and December 31, 2007, respectively	13,640	12,149
Inventories, net	38,887	24,781
Prepaid expenses and other current assets	5,970	3,569
Assets held for sale		5,140
Total current assets	95,487	84,844
Property, plant and equipment, net	19,100	15,986
Restricted deposits	6,400	6,700
Other assets	5,739	5,242
Total assets	$ 126,726	$ 112,772
Liabilities and stockholders equity:		
Current liabilities:		
Accounts payable	$ 14,228	$ 4,328
Accrued liabilities	4,639	4,326
Current portion of long-term debt	450	450
Income taxes payable	947	390
Total current liabilities	20,264	9,494
Long-term debt, net of current portion	5,962	6,250
Other long-term liabilities	3,028	3,778
Total liabilities	29,254	19,522
Commitments and contingencies (Note 10)		
Stockholders equity:		
Preferred stock, $0.001 par value per share; 2,000 shares authorized; 883 shares issued and outstanding as of June 30, 2008 and December 31, 2007.	3,532	3,532
Common stock, $0.001 par value per share; 70,000 shares authorized; 30,435 and 30,358 shares issued and outstanding as of June 30, 2008 and December 31, 2007, respectively	30	30
Additional paid-in capital	186,419	185,949
Accumulated deficit	(95,847)	(98,543)
Accumulated other comprehensive income	3,338	2,282
Total stockholders equity	97,472	93,250
Total liabilities and stockholders equity	$ 126,726	$ 112,772

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, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Revenue	$ 19,932	$ 13,639	$ 39,566	$ 26,165
Cost of revenue	13,488	8,607	26,901	15,728
Gross profit	6,444	5,032	12,665	10,437
Operating expenses:				
Selling, general and administrative	3,578	3,743	7,245	7,446
Research and development	569	348	1,073	808
Impairment (recovery) on assets held for sale		(481)	83	(481)
Total operating expenses	4,147	3,610	8,401	7,773
Income from operations	2,297	1,422	4,264	2,664
Interest income, net	241	225	365	449
Minority interests	(648)	(493)	(1,147)	(753)
Other income (expense), net	(518)	221	409	470
Income before provision for income taxes	1,372	1,375	3,891	2,830
Provision for income taxes	635	162	1,195	273
Net income	$ 737	$ 1,213	$ 2,696	$ 2,557
Net income per share:				
Basic	$ 0.02	$ 0.04	$ 0.09	$ 0.08
Diluted	$ 0.02	$ 0.04	$ 0.08	$ 0.08
Shares used in computing net income per share:				
Basic	30,421	29,943	30,403	29,871
Diluted	31,562	31,142	31,573	31,233

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, 2008	Six Months Ended June 30, 2007
Cash flows from operating activities:		
Net income	$ 2,696	$ 2,557
Adjustments to reconcile net income to net cash used in operations:		
Depreciation	967	686
Accretion of marketable securities premium/discount	(2)	(48)
Gain on disposal of property, plant and equipment	(2)	
Impairment (recovery) on assets held for sale	83	(481)
Stock-based compensation	321	211
Realized loss (gain) on sale of investments	(326)	29
Changes in assets and liabilities:		
Accounts receivable	(1,361)	(183)
Inventories	(13,598)	(4,590)
Prepaid expenses	(2,143)	(36)
Other assets	(439)	(512)
Accounts payable	9,459	(1,656)
Accrued liabilities	242	51
Income taxes	510	149
Other long-term liabilities	(908)	(26)
Net cash used in operating activities	(4,501)	(3,849)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(3,079)	(2,298)
Proceeds from sale of property, plant and equipment	4	
Proceeds from sale of assets held for sale	5,057	
Purchases of marketable securities	(11,737)	(10,254)
Proceeds from sale of marketable securities	14,495	11,911
Decrease in restricted deposits	300	300
Net cash provided by (used in) investing activities	5,040	(341)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	149	3,842
Long-term debt payments	(288)	(387)
Net cash provided by (used in) financing activities	(139)	3,455
Effect of exchange rate changes on cash and cash equivalents	512	35
Net increase (decrease) in cash and cash equivalents	912	(700)
Cash and cash equivalents at the beginning of the period	18,380	16,116
Cash and cash equivalents at the end of the period	$ 19,292	$ 15,416

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 refe AXT, Inc. and all of its consolidated subsidiaries) are unaudited, and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the year-end condensed consolidated balance sheet data was derived from our audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of our management, the unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, considered necessary to present fairly the financial position, results of operations and cash flows of AXT and our 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 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC) on March 14, 2008 and our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2008 filed with the SEC on May 12, 2008.

Note 2. Accounting for Stock-Based Compensation

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123(R)). SFAS 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee requisite service period. All of our stock compensation is accounted for as an equity instrument. We previously applied Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations and provided the required pro forma disclosures of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123 .

We elected the modified prospective transition method for adopting SFAS 123(R). Under this method, the provisions of SFAS 123(R) apply to all awards granted or modified after the date of adoption. The unrecognized expense of awards not yet vested at the date of adoption will be recognized in net income in the periods after the date of adoption using the same Black-Scholes valuation method and assumptions determined under the original provisions of SFAS 123, as disclosed in our previous quarterly and annual reports.

The effect of recording stock compensation for the three and six months ended June 30, 2008 and 2007 was as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Stock-based compensation in the form of employee stock options, included in:				
Cost of revenue	$ 15	$ 13	$ 31	$ 26
Selling, general and administrative	93	60	215	149
Research and development	43	18	75	36
Total stock-based compensation	151	91	321	211
Tax effect on stock-based compensation				
Net effect on net income	$ 151	$ 91	$ 321	$ 211
Effect on basic net income per share	$ 0.00	$ 0.00	$ 0.01	$ 0.01
Effect on diluted net income per share	$ 0.00	$ 0.00	$ 0.01	$ 0.01

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As of June 30, 2008 the total compensation costs related to unvested stock-based awards granted to employees under our stock option plan but not yet recognized was approximately $1,096,000, net of estimated forfeitures of $133,000. These costs will be amortized on a straight-line basis over a weighted-average period of approximately 2.3 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, 2008 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, 2007 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, 2008
Expected term (in years)		4.0
Volatility		60.79%
Expected dividend		0%
Risk-free interest rate		2.69%
Estimated forfeitures		4.3%
Weighted-average fair value	$	5.09

The following table summarizes the stock option transactions during six months ended June 30, 2008 (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, 2007	2,477	$	2.95			
Granted	2		5.09			
Exercised	(78)		1.92			
Canceled	(34)		7			
Options outstanding as of June 30, 2008	2,367	$	2.93	6.54	$	4,556

Options vested and expected to vest as of June 30, 2008	2,331	$	2.90	6.51	$	4,539
Options exercisable as of June 30, 2008	1,699	$	2.44	5.82	$	3,901

As of December 31, 2007, options to purchase 1,638,139 shares at a weighted average exercise price of $2.56 per share were vested and exerciseable.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing price of $4.19 as of June 30, 2008, which would have been received by the option holder had all option holders exercised their options as of that date. The total number of in-the-money options exerciseable as of June 30, 2008 was 1,572,927.

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The options outstanding and exercisable as of June 30, 2008 were in the following exercise price ranges:

	Options Outstanding as of June 30, 2008				Options Exercisable as of June 30, 2008	
Range of Exercise Price	**Shares**		**Weighted-average Exercise Price**	**Weighted-average Remaining Contractual Life**	**Shares**	**Weighted-Average Exercise Price**
$1.17 - $1.38	1,203,281	$	1.28	6.40	989,436	$ 1.28
$1.39 - $1.44	11,500	$	1.41	6.89	8,761	$ 1.41
$1.45 - $2.24	415,863	$	2.16	4.76	407,728	$ 2.16
$2.25 - $5.09	410,320	$	4.07	7.44	234,624	$ 3.64
$5.10 - $41.50	326,175	$	8.62	8.20	58,500	$ 19.17
	2,367,139	$	2.93	6.54	1,699,049	$ 2.44

The total intrinsic value of options exercised for the three and six months ended June 30, 2008, was $117,000 and $245,000, respectively. The total intrinsic value of options exercised for the three and six months ended June 30, 2007, was $90,000 and $160,000, respectively. Cash received from option exercises for the three and six months ended June 30, 2008 was $81,000 and $149,000, respectively. Cash received from option exercises for the three and six months ended June 30, 2007 was $183,000 and $228,000, respectively.

A summary of activity related to restricted stock awards for the six months ended June 30, 2008 is presented below:

	Shares		**Weighted-Average Grant Date Fair Value**
Non-vested restricted stock shares outstanding as of December 31, 2007	23,480	$	4.26
Restricted stock shares granted		$	
Restricted stock shares vested	(3,536)	$	3.77
Non-vested restricted stock shares outstanding as of June 30, 2008	19,944	$	4.26

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

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, 2008				December 31, 2007			
	Amortized Cost	**Gross Unrealized Gain**	**Gross Unrealized (Loss)**	**Fair Value**	**Amortized Cost**	**Gross Unrealized Gain**	**Gross Unrealized (Loss)**	**Fair Value**
Classified as:								

Cash	$ 19,292	$	$	$ 19,292	$ 10,818	$	$	$ 10,818
Cash equivalents:								
Money market fund					7,562			7,562
Total cash equivalents					7,562			7,562
Total cash and cash equivalents	19,292			19,292	18,380			18,380
Investments:								
U.S. Treasury, agency securities					1,400			1,400
Asset-backed securities					3,820		(77)	3,743
Commercial paper					3,300		(115)	3,185
Corporate bonds	24,841		(743)	24,098	19,051	260	(114)	19,197
Total investments	24,841		(743)	24,098	27,571	260	(306)	27,525
Total cash, cash equivalents and investments	$ 44,133		$ (743)	$ 43,390	$ 45,951	$ 260	$ (306)	$ 45,905
Contractual maturities on investments:								
Due within 1 year	$			$	$ 2,050			$ 2,050
Due after 1 through 5 years	24,841			24,098	25,521			25,475
	$ 24,841			$ 24,098	$ 27,571			$ 27,525

The investments include $6.4 million and $6.7 million recorded as restricted deposits on the condensed consolidated balance sheets as of June 30, 2008 and December 31, 2007, respectively, as a result of the outstanding principal amount on our industrial revenue bonds. Subsequently on July 1, 2008, we paid down the entire principal amount of $6.4 million plus accrued interest and accordingly the restricted deposits were released.

We manage our investments as a single portfolio of highly marketable securities that is intended to be available to meet our current cash requirements. 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. For the three and six months ended June 30, 2007 we had $19,000 and $29,000 in gross realized losses 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, 2008 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, 2008 (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	$ 24,098	$ (743)	$	$	$ 24,098	$ 743)
Total in loss position	$ 24,098	$ (743)	$	$	$ 24,098	$ (743)

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). As of June 30, 2008 and December 31, 2007, our investments in privately-held companies had a carrying value of $5.4 million and $4.9 million, respectively. The investment balances for the two companies accounted for under the equity method are included in other assets in the condensed consolidated balance sheets. We own 25% of the ownership interests in each of these companies.

Fair Value Measurements

On January 1, 2008, we adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 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 No. 157 applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, except for non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, for which application has been deferred for one year.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with SFAS No. 157 as of June 30, 2008 (in thousands):

	Balance as of June 30, 2008	Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets:			
Short-term investments:			
Corporate bonds	$ 24,098	$	$ 24,098
Total	$ 24,098	$	$ 24,098
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, 2008, 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).

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Items Measured at Fair Value on a Nonrecurring Basis

Certain assets that are subject to nonrecurring fair value measurement 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 2008.

Note 4. Inventories, Net

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

	June 30, 2008	December 31, 2007
Inventories, net:		
Raw materials	$ 18,605	$ 11,154
Work in process	15,249	12,254
Finished goods	5,033	1,373
	$ 38,887	$ 24,781

Note 5. Recovery (Impairment) on Assets Held For Sale

During the first six months of 2008, we completed the sale of our property in Fremont, California for $5.3 million in gross proceeds and $5.1 million in net proceeds after deducting commissions and selling expenses. We recorded an impairment charge upon the sale of the property of $83,000.

During the first six months of 2007, we benefited from a recovery of impairment on assets held for sale in connection with our adjustment of the fair value of the same property in Fremont, California, which has been decontaminated and was being prepared for sale. We recorded a $481,000 market value adjustment after we entered into an agreement with an independent third party purchaser in June 2007. However, the sale ultimately was not consummated.

Note 6. Net Income Per Share

Basic net income per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income 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 per share calculations is as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Numerator:				
Net income	$ 737	$ 1,213	$ 2,696	$ 2,557
Less: Preferred stock dividends	(44)	(44)	(88)	(88)
Net income available to common stockholders	$ 693	$ 1,169	$ 2,608	$ 2,469
Denominator:				
Denominator for basic net income per share - weighted average common shares	30,421	29,943	30,403	29,871
Effect of dilutive securities:				
Common stock options	1,141	1,199	1,170	1,362
Denominator for dilutive net income per common share	31,562	31,142	31,573	31,233
Basic net income per share	$ 0.02	$ 0.04	$ 0.09	$ 0.08
Diluted net income per share	$ 0.02	$ 0.04	$ 0.08	$ 0.08
Options excluded from diluted net loss per share as the impact is anti-dilutive	130	372	130	362

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Note 7. Comprehensive Income

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	$ 737	$ 1,213	$ 2,696	$ 2,557
Change in foreign currency translation gain	601	369	1,753	599
Change in unrealized gain (loss) on available-for-sale investments	(150)	443	(697)	472
Comprehensive income	$ 1,188	$ 2,025	$ 3,752	$ 3,628

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 SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information* (SFAS No. 131), our chief operating decision-maker has been identified as the Chief Executive Officer, who reviews operating results to make decisions about allocating our resources and assessing our performance. We manage the Company on a consolidated basis with a review of revenue by product. We discuss revenue and capacity for both AXT and our China joint ventures collectively, when determining capacity constraints and need for raw materials in our business, and consider their capacity when determining our strategic and product marketing and advertising strategies. While we consolidate three of the joint ventures, we do not allocate resources to any of them, nor allocate any portion of overhead, interest and other income, interest expense or taxes to them. Accordingly, we have determined that our joint venture operations do not constitute an operating segment in accordance with SFAS No. 131. Since we operate in one segment, all financial segment and product line information required by SFAS No. 131 can be found in the condensed consolidated financial statements.

Product Information

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Product by type:				
GaAs substrates	$ 13,142	$ 9,296	$ 26,862	$ 18,088
InP substrates	500	660	978	1,178
Ge substrates	1,384	402	2,769	943
Raw materials and other	4,906	3,281	8,957	5,956
Consolidated	$ 19,932	$ 13,639	$ 39,566	$ 26,165

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	
	2008	2007	2008	2007
Net revenues:				
North America*	$ 5,437	$ 2,756	$ 10,436	$ 6,098
Europe	3,966	2,606	6,783	4,671
Japan	4,595	3,012	8,735	5,398
Taiwan	2,061	2,228	4,868	4,040
Asia Pacific	3,873	3,037	8,744	5,958
Consolidated	$ 19,932	$ 13,639	$ 39,566	$ 26,165

*Primarily the United States

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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, 2008	**December 31, 2007**
Long-lived assets:		
North America	$ 209	$ 149
China	18,891	15,837
	$ 19,100	$ 15,986

Significant Customers

Two customers represented 11.6% and 11.1% of revenues for the three month period ended June 30, 2008 while no customers represented more than 10% of revenues for the three month period ended June 30, 2007. No customers represented more than 10% of revenues for the six month periods ended June 30, 2008 and 2007. Our top five customers represented 45.5% and 35.2% of revenue for the three month periods ended June 30, 2008 and 2007, respectively. Our top five customers represented 34.6% and 33.6% of revenue for the six month periods ended June 30, 2008 and 2007, respectively.

Note 9. 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. Our investments in these privately-held companies are summarized below (in thousands):

	Investment Balance as of			
Company	**June 30, 2008**	**December 31, 2007**	**Accounting Method**	**Ownership Percentage**
Beijing Ji Ya 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	2,494	2,138	Equity	25%
Emeishan Jia Mei High Purity Metals Co., Ltd	888	761	Equity	25%

The investment balances for the two companies accounted for under the equity method are included in other assets in the condensed consolidated balance sheets. 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 a 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.

Undistributed retained earnings relating to our investments were $10.1 million and $7.8 million as of June 30, 2008 and December 31, 2007, respectively. Net income recorded from our investments was $1.2 million and $955,000 for the three months ended June 30, 2008 and 2007, respectively. Net income recorded from our investments was $2.2 million and $1.6 million for the six months ended June 30, 2008 and 2007, respectively.

The minority interest for the three majority-owned joint ventures that are consolidated is included within Other long-term liabilities in the condensed consolidated balance sheets and separately disclosed under Minority interests on the condensed consolidated statements of operations. The equity earnings from the two minority-owned joint ventures that are not consolidated are recorded as Other income (expense), net on the condensed consolidated statements of operations.

We also have investments in two privately-held companies which are accounted for under the cost method as we do not have the ability to exercise significant influence over their operations. As of June 30, 2008 and December 31, 2007, these investments totaled approximately $0.4 million and are included in Other assets on the condensed consolidated balance sheets.

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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 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, 2008 and 2007 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Beginning accrued warranty and related costs	$ 996	$ 783	$ 1,030	$ 459
Charged to cost of revenue	379	244	408	696
Actual warranty expenditures	(66)	(78)	(129)	(206)
Ending accrued warranty and related costs	$ 1,309	$ 949	$ 1,309	$ 949

Note 11. Foreign Exchange Transaction Gains/Losses

We incurred foreign currency transaction exchange losses of $593,000 and $246,000 for the three month periods ended June 30, 2008, and 2007, respectively. We incurred foreign currency transaction exchange losses due to operations in general of $404,000 and $290,000 for the six month periods ended June 30, 2008, and 2007, respectively. These amounts are included in Other income (expense), net on the condensed consolidated statements of operations.

Note 12. 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 June 30, 2008, 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 unrecognized tax benefits. This 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.

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Note 13. Recent Accounting Pronouncements

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. Based on our current operations, we do not expect that the adoption of SFAS 161 will have a material impact on our consolidated financial position or results of operations.

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) is effective beginning with the Company s fiscal 2009. The impact of the adoption of SFAS 141(R) on the Company s results of operations and financial position will depend on the nature and extent of business combinations that the Company completes, 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 have not yet evaluated the impact that the adoption of SFAS 160 will have on our consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 expands the use of fair value accounting to many financial instruments and certain other items. The fair value option is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We do not have any instruments eligible for election of the fair value option. Therefore, the adoption of SFAS 159 in the first quarter of fiscal 2008 did not impact our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods of those fiscal years. In February 2008, the FASB released a FASB Staff Position (FSP FAS 157-2 *Effective Date of FASB Statement No. 157*) which delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. These non-financial items include assets and liabilities such as reporting units measured at fair value in a goodwill impairment test and non-financial assets acquired and liabilities assumed in a business combination. The partial adoption of SFAS 157 as of January 1, 2008 for financial assets and liabilities did not have a material impact on our condensed consolidated financial position, results of operations or cash flows. See Note 3 of the Notes to Condensed Consolidated Financial Statements.

Note 14. Subsequent Events

On July 1, 2008, we exercised our right to redeem the taxable variable rate revenue bond and repaid all outstanding indebtedness and accrued interest under the terms of the revenue bond of approximately $6.4 million. Accordingly, all of our remaining obligations under the revenue bond have terminated and the restricted deposits on the condensed consolidated balance sheets as of June 30, 2008 have been released.

On July 2, 2008, we entered into a new lease agreement with T. Drive Partners, L.P., a California partnership, for the approximately 27,760 square foot facility located at 4281 Technology Drive, Fremont California. The new lease commences on December 1, 2008 for a term of seven years. We have the option to cancel the lease at any time after December 1, 2013, upon forfeiture of the security deposit and payment of one-half of the fifth year s rent. The base rent for the new lease shall be $0.72 per square foot per month triple net, with annual rental increases of 4.5% per annum, payment of $50,000 security deposit, and tenant improvements of $575,000 to be amortized over seven years at 4% per annum.

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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, 2007 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 to 6	• Power amplifiers and integrated circuits for wireless handsets • Direct broadcast television • High-performance transistors • Satellite communications
GaAs (semi-conducting)	2 , 3 , 4	• High brightness LEDs • Lasers • Optical couplers
InP	2 , 3 , 4	• Broadband and fiber optic communications
Ge	2 , 4	• Satellite and terrestrial solar cells • Optical applications

We manufacture compound semiconductor substrates using our proprietary vertical gradient freeze, or VGF, technology. Our in-house VGF technology enables us to add capacity quickly and cost efficiently. We manufacture all of our products in China, which generally has lower costs for facilities, labor and materials.

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.

Revenue increased $13.4 million, or 51.2%, to $39.6 million for the six months ended June 30, 2008 from $26.2 million for the same period of 2007 primarily due to higher customer demands for six-inch diameter wafers, and an increase in germanium substrates and raw material sales. On March 28, 2008, we completed the sale of our Fremont, California facility and received net proceeds of

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approximately $5.1 million after deducting commissions and selling expenses. As of June 30, 2008, we had available cash, cash equivalents and short-term investments of $37.0 million, excluding restricted deposits. Subsequently on July 1, 2008, we exercised our right to redeem the taxable variable rate revenue bond and repaid all outstanding indebtedness and accrued interests under the terms of the revenue bond of approximately $6.4 million. Accordingly, all of our remaining obligations under the revenue bond have terminated and the restricted deposits on the condensed consolidated balance sheets as of June 30, 2008 have been released.

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 do not provide discounts or other incentives to customers.

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

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, 2008 and December 31, 2007, our accounts receivable, net, balance was $13.6 million and $12.1 million, respectively, which was net of an allowance for doubtful accounts of $126,000 and $379,000, 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, 2008 and December 31, 2007, accrued product warranties totaled $1.3 million and $1.0 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.

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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, 2008 and December 31, 2007, we had an inventory reserve of $12.8 million and $13.6 million for excess and obsolete inventory, respectively. 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 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.

We invest in equity instruments of privately-held companies for business and strategic purposes. These investments are classified as other assets and are accounted for either under the cost method or under the equity method as we do not have the ability to exercise significant influence over their operations. We monitor our investments for impairment and would 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 the 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.

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, *Accounting for Income Taxes,* (SFAS 109) 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 12 Income Taxes in the condensed consolidated financial statements for additional information.

Results of Operations

Revenue

	Three Months Ended June 30, 2008	2007	Increase (Decrease)	% Change
	($ in thousands)			
GaAs	$ 13,142	$ 9,296	$ 3,846	41.4%
InP	500	660	(160)	(24.2)%
Ge	1,384	402	982	244.3%
Raw materials	4,906	3,281	1,625	49.5%
Total revenue	$ 19,932	$ 13,639	$ 6,293	46.1%

Revenue increased $6.3 million, or 46.1%, to $19.9 million for the three months ended June 30, 2008 from $13.6 million for the three months ended June 30, 2007. Total GaAs substrate revenue increased $3.8 million, or 41.4%, to $13.1 million for the three months ended June 30, 2008 from $9.3 million for the three months ended June 30, 2007.

Sales of 5 inch and 6 inch diameter GaAs substrates were $6.1 million for the three months ended June 30, 2008 compared to $3.9 million for the three months ended June 30, 2007. The increase in larger diameter semi-insulating substrates came from the growth in demand for both cellular and WLAN (Wide Local Area Network) markets. Our growth came particularly from production orders pursuant to a supply agreement we signed in the fourth quarter of 2007 with IQE plc.

Sales of 2 inch, 3 inch and 4 inch diameter GaAs substrates were $7.1 million for the three months ended June 30, 2008 compared with $5.3 million for the three months ended June 30, 2007. The increase in revenue from smaller diameter substrates was due to the continued market growth generally of LED laser diodes and commercial epitaxy.

InP substrate revenue decreased $160,000, or 24.2%, to $500,000 for the three months ended June 30, 2008 from $660,000 for the three months ended June 30, 2007. In the three months ended June 30, 2007 we had a one-time sale of $251,000 indium scrap metal. Excluding the impact of the one-time sale, InP substrate revenue increased by $91,000 for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 due to a slight increase in demand from customers in the optical networking industry.

Ge substrate revenue increased $982,000, or 244.3%, to $1.4 million for the three months ended June 30, 2008 from $402,000 for the three months ended June 30, 2007. The increase in Ge substrate revenue was due to an increase in sales to customers in the People s Republic of China and an increase in sales to a major customer in Europe who has now qualified our product, as demand for photovoltaic applications increases.

Raw materials revenue increased $1.6 million, or 49.5%, to $4.9 million for the three months ended June 30, 2008 from $3.3 million for the three months ended June 30, 2007. The increase in raw materials revenue was primarily due to a combination of increased sales to customers as demand increased and higher raw materials prices. We do not expect demand to continue at this pace for the remainder of 2008.

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	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Increase (Decrease)	% Change
	($ in thousands)			
GaAs	$ 26,862	$ 18,088	$ 8,774	48.5%
InP	978	1,178	(200)	(17.0)%
Ge	2,769	943	1,826	193.6%
Raw materials	8,947	5,911	3,036	51.4%
Other	10	45	(35)	(77.8)%
Total revenue	$ 39,566	$ 26,165	$ 13,401	51.2%

Revenue increased $13.4 million, or 51.2%, to $39.6 million for the six months ended June 30, 2008 from $26.2 million for the six months ended June 30, 2007. Total GaAs substrate revenue increased $8.8 million, or 48.5%, to $26.9 million for the six months ended June 30, 2008 from $18.1 million for the six months ended June 30, 2007.

Sales of 5 inch and 6 inch diameter GaAs substrates were $12.9 million for the six months ended June 30, 2008 compared to $8.0 million for the six months ended June 30, 2007. The increase in larger diameter semi-insulating substrates came from the growth in demand for both cellular and WLAN (Wide Local Area Network) markets. Our growth came particularly from production orders pursuant to a supply agreement we signed in the fourth quarter of 2007 with IQE plc.

Sales of 2 inch, 3 inch and 4 inch diameter GaAs substrates were $13.9 million for the six months ended June 30, 2008 compared with $10.1 million for the six months ended June 30, 2007. The increase in revenue from smaller diameter substrates was due to the continued market growth generally of LED laser diodes and commercial epitaxy.

InP substrate revenue decreased $200,000, or 17.0%, to $978,000 for the six months ended June 30, 2008 from $1.2 million for the six months ended June 30, 2007. In the three months ended June 30, 2007 we had a one-time sale of $251,000 indium scrap metal. Excluding the impact of the one-time sale, InP substrate revenue increased $51,000 for the six months ended June 30, 2008 compared to the six months ended June 30, 2007due to a slight increase in demand from customers in the optical networking industry.

Ge substrate revenue increased $1.8 million, or 193.6%, to $2.8 million for the six months ended June 30, 2008 from $943,000 for the six months ended June 30, 2007. The increase in Ge substrate revenue was due to an increase in sales to customers in the People s Republic of China and an increase in sales to a major customer in Europe who has now qualified our product, as demand for photovoltaic applications increases.

Raw materials revenue increased $3.0 million, or 51.4%, to $8.9 million for the six months ended June 30, 2008 from $5.9 million for the six months ended June 30, 2007. The increase in raw materials revenue was primarily due to a combination of increased sales to customers as demand increased and higher raw materials prices. We do not expect demand to continue at this pace for the remainder of 2008.

Revenue by Geographic Region

	Three Months Ended June 30, 2008	2007	Increase (Decrease)	% Change
	($ in thousands)			
North America *	$ 5,437	$ 2,756	$ 2,681	97.3%
% of total revenue	27%	20%		
Europe	3,966	2,606	1,360	52.2%
% of total revenue	20%	19%		
Japan	4,595	3,012	1,583	52.6%
% of total revenue	23%	22%		
Taiwan	2,061	2,228	(167)	(7.5)%
% of total revenue	10%	17%		
Asia Pacific (excluding Japan and Taiwan)	3,873	3,037	836	27.5%
% of total revenue	20%	22%		
Total revenue	$ 19,932	$ 13,639	$ 6,293	46.1%

*Primarily the United States

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Revenue from customers in North America increased by $2.7 million, or 97.3%, to $5.4 million for the three months ended June 30, 2008 from $2.8 million for the three months ended June 30, 2007. We expected our North America revenue to increase substantially in 2008 based upon a supply agreement we signed in the fourth quarter of 2007 with IQE plc. Under the terms of the agreement, IQE plc shall purchase from us a minimum of approximately $15.1 million of 4-inch and 6-inch semi-insulating gallium arsenide (GaAs) substrates. IQE plc has an option to purchase an additional $3.5 million of 6-inch substrates from us under the agreement. All substrates ordered pursuant to the agreement are to be shipped by the end of 2008.

Revenue from customers in Europe increased by $1.4 million, or 52.2%, to $4.0 million for the three months ended June 30, 2008 from $2.6 million for the three months ended June 30, 2007. This increase came primarily from increased substrate sales to customers in Germany and France, and to a lesser extent from increased sales to a customer in the United Kingdom that is part of the IQE plc group with whom we signed a supply agreement in the fourth quarter of 2007.

Revenue from customers in Japan increased by $1.6 million, or 52.6%, to $4.6 million for the three months ended June 30, 2008 from $3.0 million for the three months ended June 30, 2007. The increase came from $1.2 million increased substrate sales to two major existing customers, particularly in large diameter wafers, and from $0.4 million increased raw material sales of 4N gallium.

Revenue from customers in Taiwan decreased by $167,000, or 7.5%, to $2.1 million for the three months ended June 30, 2008 from $2.2 million for the three months ended June 30, 2007. The decrease came mainly from one major existing customer for large diameter wafers.

Revenue from customers in Asia Pacific (excluding Japan and Taiwan) increased by $0.8 million, or 27.5%, to $3.9 million for the three months ended June 30, 2008 from $3.0 million for the three months ended June 30, 2007. Sales to customers in the People s Republic of China increased by $1.1 million, of which raw materials was $0.5 million, while $0.6 million was from increased sales to existing customers for small diameter GaAs wafers. Sales to a major customer in Singapore that is part of the IQE plc group decreased by $0.5 million as they shifted some purchases to other geographic areas. Sales to customers in Korea increased by $0.2 million as demand increased in smaller diameter wafers.

	Six Months Ended June 30, 2008	2007	Increase (Decrease)	% Change
	($ in thousands)			
North America *	$ 10,436	$ 6,098	$ 4,338	71.1%
% of total revenue	27%	23%		
Europe	6,783	4,671	2,112	45.2%
% of total revenue	17%	18%		
Japan	8,735	5,398	3,337	61.8%
% of total revenue	22%	21%		
Taiwan	4,868	4,040	828	20.5%
% of total revenue	12%	15%		
Asia Pacific (excluding Japan and Taiwan)	8,744	5,958	2,786	46.8%
% of total revenue	22%	23%		
Total revenue	$ 39,566	$ 26,165	$ 13,401	51.2%

*Primarily the United States

Revenue from customers in North America increased by $4.3 million, or 71.1%, to $10.4 million for the six months ended June 30, 2008 from $6.1 million for the six months ended June 30, 2007. We expected our North America revenue to increase substantially in 2008 based upon a supply agreement we signed in the fourth quarter of 2007 with IQE plc. Under the terms of the agreement, IQE plc shall purchase from us a minimum of approximately $15.1 million of 4-inch and 6-inch semi-insulating gallium arsenide (GaAs) substrates. IQE plc has an option to purchase an additional $3.5 million of 6-inch substrates from us under the agreement. All substrates ordered pursuant to the agreement are to be shipped by the end of 2008.

Revenue from customers in Europe increased by $2.1 million, or 45.2%, to $6.8 million for the six months ended June 30, 2008 from $4.7 million for the six months ended June 30, 2007. This increase came primarily from increased substrate sales to customers in Germany and France, and to a lesser extent from increased sales to a customer in the United Kingdom that is part of the IQE plc group with whom we signed a supply agreement in the fourth quarter of 2007.

Revenue from customers in Japan increased by $3.3 million, or 61.8%, to $8.7 million for the six months ended June 30, 2008 from $5.4 million for the six months ended June 30, 2007. The increase came from $2.8 million increased substrate sales to two major existing customers, particularly in large diameter wafers, and from $0.5 million increased raw material sales of 4N gallium.

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Revenue from customers in Taiwan increased by $0.8 million, or 20.5%, to $4.9 million for the six months ended June 30, 2008 from $4.0 million for the six months ended June 30, 2007. The increase came mainly from one major existing customer for large diameter wafers.

Revenue from customers in Asia Pacific (excluding Japan and Taiwan) increased by $2.8 million, or 46.8%, to $8.7 million for the six months ended June 30, 2008 from $6.0 million for the six months ended June 30, 2007. Sales to customers in the People s Republic of China increased by $2.8 million, of which raw materials was $1.1 million, while $1.7 million was from increased sales to existing customers for small diameter GaAs wafers. Sales to a major customer in Singapore that is part of the IQE plc group decreased by $0.3 million as they shifted some purchases to other geographic areas. Sales to customers in Korea increased by $0.3 million as demand increased in smaller diameter wafers.

Gross Margin

	Three Months Ended June 30, 2008	2007	Increase (Decrease)	% Change
	($ in thousands)			
Gross profit	$ 6,444	$ 5,032	$ 1,412	28.1%
Gross Margin %	32.3%	36.9%		

Gross margin decreased to 32.3% of total revenue for the three months ended June 30, 2008 from 36.9% of total revenue for the three months ended June 30, 2007. Gross margins in the three months ended June 30, 2008 and 2007 were positively impacted by sales of approximately $735,000 and $387,000, respectively, of GaAs wafers that were previously fully reserved. In the three months ended June 30, 2007 we had manufacturing equipment that had become fully depreciated since the third quarter of 2006, and the absence of depreciation expense for this equipment, partially offset by depreciation on property, plant and equipment additions, contributed approximately 3.3 percentage points to gross margin in the three months ended June 30, 2007. In addition, we had a one-time sale of $251,000 indium scrap metal that contributed approximately 1.8 percentage points to gross margin in the three months ended June 30, 2007. In the subsequent four quarters since June 30, 2007, 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.

	Six Months Ended June 30, 2008	2007	Increase (Decrease)	% Change
	($ in thousands)			
Gross profit	$ 12,665	$ 10,437	$ 2,228	21.3%
Gross Margin %	32.0%	39.9%		

Gross margin decreased to 32.0% of total revenue for the six months ended June 30, 2008 from 39.9% of total revenue for the six months ended June 30, 2007. Gross margins in the six months ended June 30, 2008 and 2007 were positively impacted by sales of approximately $1.4 million and $1.2 million, respectively, of GaAs wafers that were previously fully reserved. In the six months ended June 30, 2007 we had manufacturing equipment that had become fully depreciated since the third quarter of 2006, and the absence of depreciation expense for this equipment, partially offset by depreciation on property, plant and equipment additions, contributed approximately 3.2 percentage points to gross margin in the six months ended June 30, 2007. In addition, we had a one-time sale of $251,000 indium scrap metal that contributed approximately 1.0 percentage points to gross margin in the six months ended June 30, 2007. In the subsequent four quarters since June 30, 2007, 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.

Selling, General and Administrative Expenses

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Increase (Decrease)	% Change
	($ in thousands)			
Selling, general and administrative expenses	$ 3,578	$ 3,743	$ (165)	-4.4%
% of total revenue	18.0%	27.4%		

Selling, general and administrative expenses decreased $165,000 to $3.6 million for the three months ended June 30, 2008 from $3.7 million for the three months ended June 30, 2007. The decrease was primarily due to $629,000 lower bad debt expenses as we collected from our slow-paying customers in Asia, partially offset by increases of $297,000 in general annual salary and related labor costs, $51,000 in stock based compensation expenses, $42,000 in health insurance costs, $32,000 in rent expenses, and $24,000 in sales commissions based on increased sales volumes.

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	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Increase (Decrease)	% Change
	($ in thousands)			
Selling, general and administrative expenses	$ 7,245	$ 7,446	$ (201)	-2.7%
% of total revenue	18.3%	28.5%		

Selling, general and administrative expenses decreased $201,000, or 2.7% to $7.2 million for the six months ended June 30, 2008 from $7.4 million for the six months ended June 30, 2007. The decrease was primarily due to $813,000 lower bad debt expenses as we collected from our slow-paying customers in Asia and $412,000 lower legal fees, partially offset by increases of $733,000 in general annual salary and related labor costs, $86,000 in sales commissions based on increased sales volumes, and $84,000 in stock based compensation.

Research and Development

	Three Months Ended June 30, 2008	2007	Increase (Decrease)	% Change
	($ in thousands)			
Research and development	$ 569	$ 348	$ 221	63.5%
% of total revenue	2.9%	2.6%		