

APPLIED OPTOELECTRONICS, INC.

Form 10-Q

August 07, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended June 30, 2015

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-36083

Applied Optoelectronics, Inc.

(Exact name of registrant as specified in its charter)

Delaware

76-0533927

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

13115 Jess Pirtle Blvd.

Sugar Land, TX 77478

(Address of principal executive offices)

(281) 295-1800

(Registrant's telephone number)

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 Exchange Act of 1934 ("Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ☐

Accelerated filer

☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: as of August 3, 2015 there were 15,122,710 shares of the registrant's Common Stock outstanding.

Applied Optoelectronics, Inc.

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Part I. Financial Information**Item 1. Condensed Consolidated Financial Statements****Applied Optoelectronics, Inc. and Subsidiaries****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except per share data)**

	June 30, 2015	December 31, 2014
	(Unaudited)	
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 28,412	\$ 32,175
Restricted cash	2,495	509
Short-term investments	8,324	8,189
Accounts receivable - trade, net	32,907	31,589
Inventories	52,451	33,780
Notes receivable	—	980
Prepaid expenses and other current assets	8,031	6,017
Total current assets	132,620	113,239
Cash restricted for construction in progress	5,089	—
Property, plant and equipment, net	78,979	64,808
Land use rights, net	919	930
Intangible assets, net	3,837	3,833
Other assets, net	1,303	860
TOTAL ASSETS	\$ 222,747	\$ 183,670
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	\$ 30,990	\$ 9,591
Accounts payable	29,755	30,799
Bank acceptance payable	2,660	1,271
Accrued liabilities	7,348	6,940
Total current liabilities	70,753	48,601
Long-term debt, less current portion	29,596	19,057
Other long term liabilities	500	1,000
TOTAL LIABILITIES	100,849	68,658
Stockholders' equity (deficit):		
Preferred Stock: 5,000 shares authorized; no shares issued and outstanding at June 30, 2015 and December 31, 2014, \$0.001 par value	—	—

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Common Stock: 45,000 shares authorized; 14,949 shares issued and outstanding at June 30, 2015, \$0.001 par value; 14,824 shares issued and outstanding at December 31, 2014, \$0.001 par value	15	15
Additional paid-in capital	193,488	192,112
Accumulated other comprehensive gain	2,021	1,925
Accumulated deficit	(73,626)	(79,040)
TOTAL STOCKHOLDERS' EQUITY	121,898	115,012
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 222,747	\$ 183,670

The accompanying notes are an integral part of these condensed consolidated financial statements.

Applied Optoelectronics, Inc. and Subsidiaries**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited, in thousands, except share and per share data)**

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Revenue, net	\$49,632	\$32,650	\$79,866	\$57,509
Cost of goods sold	32,901	21,462	53,084	37,668
Gross profit	16,731	11,188	26,782	19,841
Operating expenses				
Research and development	4,701	4,009	9,506	7,555
Sales and marketing	1,607	1,497	3,166	2,830
General and administrative	4,534	3,952	9,537	7,506
Total operating expenses	10,842	9,458	22,209	17,891
Income from operations	5,889	1,730	4,573	1,950
Other income (expense)				
Interest income	80	106	154	185
Interest expense	(300)	(60)	(425)	(222)
Other income, net	555	228	1,247	201
Total other income	335	274	976	164
Income before income taxes	6,224	2,004	5,549	2,114
Income taxes	(135)	(85)	(135)	(110)
Net income	\$6,089	\$1,919	\$5,414	\$2,004
Net income per share				
Basic	\$0.41	\$0.13	\$0.36	\$0.15
Diluted	\$0.38	\$0.12	\$0.34	\$0.14
Weighted average shares used to compute net income per share				
Basic	14,936,442	14,785,437	14,890,581	13,794,384
Diluted	15,871,745	15,641,694	16,015,158	14,620,570

The accompanying notes are an integral part of these condensed consolidated financial statements.

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited, in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Net income	\$6,089	\$1,919	\$5,414	\$2,004
Foreign currency translation adjustment, net of tax	119	139	96	(140)
Comprehensive income	\$6,208	\$2,058	\$5,510	\$1,864

The accompanying notes are an integral part of these condensed consolidated financial statements.

Applied Optoelectronics, Inc. and Subsidiaries**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)****Six months ended June 30, 2015****(Unaudited, in thousands)**

	Common Stock			Accumulated other comprehensive gain	Accumulated deficit	Total stockholders' equity
	Number of shares	Amount	Additional paid-in capital			
December 31, 2014	14,824	\$ 15	\$ 192,112	\$ 1,925	\$ (79,040)) \$ 115,012
Issuance of shares under equity plans	125	—	327	—	—	\$ 327
Stock based compensation	—	—	1,049	—	—	\$ 1,049
Net income	—	—	—	—	5,414	\$ 5,414
Foreign currency translation adjustment	—	—	—	96	—	\$ 96
June 30, 2015	14,949	\$ 15	\$ 193,488	\$ 2,021	\$ (73,626)) \$ 121,898

The accompanying notes are an integral part of these condensed consolidated financial statements.

Applied Optoelectronics, Inc. and Subsidiaries**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited, in thousands)**

	Six months ended June 30, 2015	2014
Operating activities:		
Net income	\$ 5,414	\$ 2,004
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for obsolete inventory	1,251	768
Depreciation and amortization	4,313	2,670
Loss (gain) on disposal of assets	10	(1)
Share-based compensation and warrant expense	1,049	1,007
Changes in operating assets and liabilities:		
Accounts receivable	(1,234)	(2,829)
Notes receivable	980	(463)
Inventory	(19,683)	(12,360)
Other current assets	(1,908)	(1,012)
Accounts payable	(1,118)	9,337
Accrued liabilities	340	1,097
Net cash provided by (used in) operating activities	(10,586)	218
Investing activities:		
Purchase of short-term investments	(124)	(53)
Change in restricted cash for construction in progress	(5,089)	—
Purchase of property, plant and equipment	(17,379)	(13,101)
Proceeds from disposal of equipment	45	12
	(418)	(813)

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Deposits and deferred charges				
Purchase of intangible assets	(205)	(3,153)
Net cash used in investing activities	(23,170)	(17,108)
Financing activities:				
Proceeds from issuance of long-term debt	8,357		3,150	
Principal payments of long-term debt	(870)	(8,076)
Proceeds from line of credit borrowings	72,006		10,763	
Repayments of line of credit borrowings	(47,855)	(22,304)
Proceeds from bank acceptance payable	3,405		3,826	
Repayments of bank acceptance payable	(2,016)	(3,773)
Repayments of notes payable	(500)	(250)
Increase in restricted cash	(1,975)	(164)
Exercise of stock options	327		219	
Proceeds from common stock offering, net	—		45,630	
Net cash provided by financing activities	30,879		29,021	
Effect of exchange rate changes on cash	(886)	(58)
Net increase (decrease) in cash	(3,763)	12,073	
Cash and cash equivalents at beginning of period	32,175		22,006	
Cash and cash equivalents at end of period	\$ 28,412		\$ 34,079	
Supplemental disclosure of cash flow information:				
Cash paid for:				
Interest	\$ 462		\$ 254	
Income taxes	\$ 117		\$ 71	
Non-cash investing and financing activities:				
	\$ —		\$ 3,000	

Purchase of intangible
assets with notes
payable

The accompanying notes are an integral part of these condensed consolidated financial statements.

Applied Optoelectronics, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Description of Business

Business Overview

Applied Optoelectronics, Inc., or AOI, was originally incorporated in Texas in February of 1997 and then converted to a Delaware corporation in March of 2013. AOI together with its wholly-owned subsidiaries are collectively referred to as the Company. The Company is a leading, vertically integrated provider of fiber-optic networking products, primarily for three networking end-markets: internet data centers, cable television, and fiber-to-the-home. The Company designs and manufactures a wide range of optical communications products at varying levels of integration, from components, subassemblies and modules to complete turn-key equipment.

The Company has manufacturing and research and development facilities in all three of its locations, located in the U.S., Taiwan and China. At its corporate headquarters and manufacturing facilities in Sugar Land, Texas, the Company primarily manufactures lasers and laser components and performs research and development activities for laser component products. The Company operates a division in Taipei, Taiwan that primarily manufactures transceivers for both the data center and fiber-to-the-home (“FTTH”) markets and performs research and development activities for the transceiver products. The Company operates in Ningbo, China through its wholly-owned subsidiary Prime World International Holdings, Ltd. (incorporated in the British Virgin Islands). Prime World International Holdings, Ltd., is the sole parent of Global Technology, Inc. (incorporated in the People’s Republic of China). Through Global Technology Inc, the Company primarily manufactures Cable TV Broadband (“CATV”) systems and equipment and performs research and development activities for the CATV products.

Interim Financial Statements

The condensed consolidated financial statements of the Company, as of June 30, 2015 and December 31, 2014 and for the three and six months ended June 30, 2015 and June 30, 2014, have been prepared in accordance with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In accordance with those rules and regulations, the Company has omitted certain information and notes normally provided in the Company’s annual consolidated financial statements. In the opinion of management, the condensed consolidated financial statements contain all adjustments, except as otherwise noted, necessary for the fair

presentation of the Company's financial position and results of operations for the periods presented. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles ("GAAP"). These condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K ("Annual Report") for the fiscal year ended December 31, 2014. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates in the consolidated financial statements and accompanying notes. Significant estimates and assumptions that impact these financial statements and the accompanying notes relate to, among other things, allowance for doubtful accounts, valuation allowances for deferred tax assets, inventory reserve, share-based compensation expense, estimated useful lives of property and equipment, and taxes.

Note 2. Significant Accounting Policies

There have been no changes in the Company's significant accounting policies for the three and six months ended June 30, 2015, as compared to the significant accounting policies described in its Annual Report.

Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. In April 2015, the FASB deferred this standard's effective date by one year. The deferral allows early adoption at the original effective date. Entities have the option of either a full retrospective or a modified retrospective approach to adopt this new guidance. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory* ("ASU 2015-11"). The amendments in ASU 2015-11 clarify the subsequent measurement of inventory requiring an entity to subsequently measure inventory at the lower of

cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This ASU applies only to inventory that is measured using the first-in, first-out (FIFO) or average cost method. Subsequent measurement is unchanged for inventory measured using last-in, first-out (LIFO) or the retail inventory method. The amendments in ASU 2015-11 should be applied prospectively and are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The company is currently assessing the impact that this standard will have on its consolidated financial statements.

Note 3. Fair Value of Financial Instruments

The following table presents a summary of the Company's financial instruments measured at fair value on a recurring basis for the periods indicated (in thousands):

	As of June 30, 2015				As of December 31, 2014			
	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)	Total
Assets:								
Cash and cash equivalents	\$28,412	\$—	\$ —	\$28,412	\$32,175	\$—	\$ —	\$32,175
Restricted cash	2,495	—	—	2,495	509	—	—	509
Short term investments	8,324	—	—	8,324	8,189	—	—	8,189
Notes receivable	—	—	—	—	—	980	—	980
Cash restricted for construction in progress	5,089	—	—	5,089	—	—	—	—
Total assets	\$44,320	\$—	\$ —	\$44,320	\$40,873	\$980	\$ —	\$41,853
Liabilities:								
Bank acceptance payable	—	2,660	—	2,660	—	1,271	—	1,271
Total liabilities	\$—	\$2,660	\$ —	\$2,660	\$—	\$1,271	\$ —	\$1,271

The carrying value amounts of accounts receivable, prepaid expenses and other current assets, borrowings from our credit facility, accounts payable, accrued expenses and other current liabilities approximate fair value because of the short-term maturity of these instruments.

Note 4. Earnings Per Share

Basic net income per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net income per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from stock options, restricted stock units/awards and warrants outstanding during the period. In periods with net losses, normally dilutive shares become anti-dilutive, and therefore for those periods basic and dilutive earnings per share are the same.

The following table sets forth the computation of the basic and diluted net loss per share for the periods indicated (in thousands, except per share amounts):

	Three months ended June 30, 2015		Six months ended June 30, 2015	
	2015	2014	2015	2014
Numerator:				
Net income	\$6,089	\$1,919	\$5,414	\$2,004
Denominator:				
Weighted average shares used to compute net income per share				
Basic	14,936	14,785	14,891	13,794
Effect of dilutive options and warrants	936	857	1,124	827
Diluted	15,872	15,642	16,015	14,621
Net income per share				
Basic	\$0.41	\$0.13	\$0.36	\$0.15
Diluted	\$0.38	\$0.12	\$0.34	\$0.14

There were no securities that were excluded from the computation of diluted net income per share.

Note 5. Inventory

Inventories consist of the following for the periods indicated (in thousands):

	June 30, 2015	December 31, 2014
Raw materials	\$20,145	\$ 16,243
Work in process	23,984	13,379
Finished goods	8,322	4,158
	\$52,451	\$ 33,780

The lower of cost or market adjustment expensed for inventory for the three months ended June 30, 2015 and 2014 was \$0.7 million and \$0.5 million, respectively. The lower of cost or market adjustment expensed for inventory for the six months ended June 30, 2015 and 2014 was \$1.3 million and \$0.8 million, respectively.

Note 6. Property, Plant & Equipment

Property, plant and equipment consisted of the following for the periods indicated (in thousands):

	June 30, 2015	December 31, 2014
Land improvements	\$850	\$ 103
Building and improvements	26,532	16,196
Machinery and equipment	71,662	61,529
Furniture and fixtures	2,105	1,938
Computer equipment and software	5,553	4,712
Transportation equipment	273	270
	106,975	84,748
Less accumulated depreciation and amortization	(36,477)	(32,412)
	70,498	52,336
Construction in progress	7,380	11,371
Land	1,101	1,101
Property, plant and equipment, net	\$78,979	\$ 64,808

For the three months ended June 30, 2015 and 2014, depreciation expense of property, plant and equipment was \$2.2 million and \$1.3 million, respectively. For the six months ended June 30, 2015 and 2014, depreciation expense of property, plant and equipment was \$4.1 million and \$2.5 million, respectively.

Note 7. Intangible Assets

Intangible assets consisted of the following for the periods indicated (in thousands):

	June 30, 2015		
	Gross Amount	Accumulated amortization	Intangible assets, net
Patents	\$5,172	\$ (1,340)	\$ 3,832
Trademarks	14	(9)	5
Total intangible assets	5,186	(1,349)	3,837

	December 31, 2014		
	Gross Amount	Accumulated amortization	Intangible assets, net
Patents	\$4,968	\$ (1,141)	\$ 3,827
Trademarks	14	(8)	6
Total intangible assets	4,982	(1,149)	3,833

For the three months ended June 30, 2015 and 2014, amortization expense for intangible assets, included in general and administrative expenses on the income statement, was \$102,000 and \$95,000, respectively. For the six months ended June 30, 2015 and 2014, amortization expense for intangible assets, included in general and administrative expenses on the income statement, was \$201,000 and \$164,000, respectively. The remaining weighted average amortization period for intangible assets is approximately 10 years.

In 2014 the Company acquired an intangible asset from an unrelated company in the form of a license to various patents related to transceiver product technology. The weighted-average amortization period for the license is 10 years.

Note 8. Notes Payable and Long-Term Debt

Notes payable and long-term debt consisted of the following for the periods indicated (in thousands):

	June 30, 2015	December 31, 2014
Revolving line of credit with a U.S. bank up to \$20,000 with interest at LIBOR plus 2.75%, maturing June 30, 2018	20,000	15,000
Revolving line of credit with a U.S. bank up to \$5,000 with interest at LIBOR plus 3.0%, due every 90 days, maturing June 30, 2018	5,000	—
Term loan with a U.S. bank with monthly payments of principal and interest at LIBOR plus 2.75%, maturing July 31, 2019	4,623	5,000
Term loan with a U.S. bank with monthly payments of principal and interest at LIBOR plus 2.75%, maturing June 30, 2020	2,000	—
Revolving line of credit with a Taiwan bank up to \$3,000 with interest based on the bank's corporate interest rate index+ 1.5%, or 2.40% maturing on November 15, 2015	2,296	—
Revolving line of credit with a Taiwan bank up to \$7,000 with interest at Taiwan deposit index plus 0.38% or LIBOR plus 1.7% maturing on February 6, 2016	5,908	3,605
Revolving line of credit with a Taiwan bank up to \$4,000 with interest at Taiwan Time Deposit Interest Rate Index plus 0.41% or LIBOR plus 1.28% maturing on December 11, 2015	3,624	3,536
Revolving line of credit with a China bank up to \$5,000 with interest ranged from 2.15% to 3.15%, which mature between July and September 2015	4,014	1,064
Revolving line of credit with a China bank up to \$4,432 with interest at 108% of China Prime rate, or 5.79%, maturing April 17, 2016	3,926	—
Revolving line of credit with the Taiwan branch of a China bank up to \$3,000 with interest at LIBOR plus 1.5% or Taiwan Interbank Offered Rate plus 0.9% , maturing April 1, 2016	2,917	—
Note payable to a finance company due in monthly installments with 4.95% interest, maturing July 30, 2015	65	443
	6,213	—

Note payable to a finance company due in monthly installments with 4.5% interest, maturing from May 27, 2018 to June 30, 2018

Total	60,586	28,648
Less current portion	(30,990)	(9,591)
Long term portion	\$29,596	\$ 19,057

Bank Acceptance Notes Payable

Bank acceptance notes issued to vendors with a zero percent interest rate, a 30% guarantee deposit of \$797, and maturity dates ranging from July 2015 to December 2015	2,660	1,271
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The current portion of long-term debt is the amount payable within one year of the balance sheet date of June 30, 2015. The one-month LIBOR rate was 0.186% on June 30, 2015.

Maturities of long-term debt are as follows for the future one-year periods ending June 30 (in thousands):

2016	\$30,990
2017	3,739
2018	23,631
2019 thereafter	2,226
Total outstanding	\$60,586

On June 30, 2015, the Company entered into with East West Bank and Comerica Bank a credit agreement, a second lien deed of trust, multiple security agreements and promissory notes evidencing two credit facilities and a term loan. The credit agreement included a \$25.0 million revolving line of credit which matures on June 30, 2018 and a \$10 million term loan maturing on June 30, 2020. The interest rate on these loans is the LIBOR Borrowing Rate plus 2.75% or 3.0%. As of June 30, 2015, \$25.0 million was outstanding under the revolving line of credit and \$2.0 million was outstanding under the term loans.

Also with East West Bank was a term loan of \$5 million with monthly payments of principal and interest that matures on July 31, 2019. As of June 30, 2015, the outstanding balance of such term loan was \$4.6 million.

On January 26, 2015, the Company entered into a construction loan agreement with East West Bank for up to \$22.0 million dollars to finance the construction of its campus expansion plan in Sugar Land, Texas. Upon signing the agreement, the Company deposited \$11.0 million into a restricted bank account for owner's contribution of construction costs. The loan will have a fifteen month draw down period with monthly interest payments commencing on February 26, 2015 and ending April 26, 2016. Thereafter, the entire outstanding principal balance shall be converted to a sixty-nine month term loan with principal and interest payments due monthly amortized over three hundred months. The first principal and interest payment is due on May 26, 2016 and will continue the same day of each month thereafter. The final principal and interest payment is due on January 26, 2022 and will include all unpaid principal and all accrued and unpaid interest. The Company may pay without penalty all or a portion of the amount owed earlier than due. Under the loan agreement, the loan bears interest, at an annual rate based on the one-month LIBOR Borrowing Rate plus 2.75%. As of June 30, 2015, there were no amounts outstanding under this loan agreement and there was a balance of \$5.1 million in the restricted bank account.

The loan and security agreements with East West Bank and Comerica Bank require the Company to maintain certain financial covenants, including a minimum current ratio and minimum annual EBITDA. As of June 30, 2015, the Company was in compliance with all covenants contained in these agreements.

On January 6, 2015, the Company's Taiwan branch entered into a Credit Facility with CTBC Bank Co. Ltd. in Taipei, Taiwan for 90.0 million New Taiwan dollar (\$3.0 million USD), one year revolving credit facility. Its obligations under the Credit Facility are unsecured. Borrowings under the Credit Facility will bear interest at a rate based on the Bank's corporate interest rate index plus 1.5%, adjusted monthly. As of the execution of the Credit Facility the Bank's corporate interest rate index is 0.91%. As of June 30, 2015, \$2.3 million was outstanding under this credit facility.

On March 9, 2015, the Company's Taiwan branch increased its \$4.0 million, to a \$7.0 million revolving credit facility agreement, with E. Sun Commercial Bank. Its obligations under the credit facility are secured by our \$4.0 million cash deposit in a one-year CD with such bank and mature on May 27, 2016. The \$4.0 million revolving line of credit with CD security bears interest at a rate equal to Taiwan Deposit Index Rate plus 0.38% for New Taiwan dollar borrowings and a 0.1% service fee for U.S. dollar borrowings. The additional \$3.0 million credit facility bears interest at a rate

equal to LIBOR plus 1.7% divided by 0.946 and a 0.5% service fee for U.S. dollar borrowings. As of June 30, 2015, \$5.9 million was outstanding under this credit facility.

On March 25, 2015, the Company's Taiwan branch renewed its \$4.0 million, one year revolving credit facility agreement, originally dated December 31, 2013, with Mega International Commercial Bank. Obligations under the credit facility are secured by a \$4.0 million cash deposit in a CD with such bank. Borrowings under this credit facility will bear interest at a rate not less than the LIBOR borrowing rate plus 1.0%, divided by 0.946 for U.S. and other currency borrowings, New Taiwan dollar borrowings interest will bear at a rate equal to the Bank's base lending rate plus 0.76%. The current effective interest rate is 1.77%. As of June 30, 2015, \$3.6 million was outstanding under this credit facility.

On April 1, 2015, the Company's Taiwan branch entered into a comprehensive credit line agreement with the Taipei branch of China Construction Bank, providing a revolving credit line of \$3 million, maturing on April 1, 2016. Borrowings under the credit line agreement are secured by a standby letter of credit issued by the China branch of the bank under existing agreements between the bank and our China subsidiary. Borrowings under the credit line agreement reduce the amounts available under of the existing credit line between the bank and the Company's China subsidiary and cannot exceed 97% of the amount of the standby letter of credit issued by the China branch of the bank. Borrowings under the credit line agreement will bear interest at a rate not less than LIBOR plus 1.5% for US dollar borrowings and at a rate of not less than Taiwan Interbank Offered Rate plus 0.9% for New Taiwan dollar borrowings. As of June 30, 2015, \$2.9 million was outstanding under this credit facility.

The Company's Taiwan branch had an outstanding note payable balance of \$0.1 million with a financing company that matures on July 30, 2015.

On June 30, 2015, the Company's Taiwan branch entered into a purchase and sale contract and a finance lease agreement together with the sale contract with Chailease Finance Co, Ltd. in connection with certain equipment, structured as a sale lease-back transaction. Pursuant to the sale contract, the Company sold certain equipment to Chailease and simultaneously leased the equipment back from Chailease pursuant to the finance lease agreement. The finance lease agreement has a three year term, with monthly lease payments, maturing on May 27 and June 30, 2018 respectively. The title to the equipment will be transferred to the Company upon the expiration of the finance lease agreement. As of June 30, 2015, \$6.2 million was outstanding under this finance lease agreement.

As of June 30, 2015, the Company's China subsidiary had credit facilities with China Construction Bank totaling \$12.1 million, which can be drawn in U.S. currency, RMB currency or issuing bank acceptance notes to vendors with different interest rates. As of June 30, 2015, the Company had a U.S. currency based loan of \$4.0 million outstanding under various notes with three-month terms, maturing from July 2015 to September 2015 with effective interest rate of 3.15%. There was \$3.9 million outstanding RMB currency cash loan as of June 30, 2015, with a maturity date of April 26, 2016. The effective interest rate for the RMB currency loan was 5.79%. The outstanding balance of bank acceptance notes issued to vendors was \$2.7 million with zero interest rate as of June 30, 2015.

As of June 30, 2015, the Company had \$41.1 million of unused borrowing capacity.

Note 9. Accrued Liabilities

Accrued liabilities consisted of the following for the periods indicated (in thousands):

	June 30, 2015	December 31, 2014
Accrued payroll	\$4,117	\$ 3,662
Accrued employee benefits	629	808
Accrued income taxes	74	52
Accrued state and local taxes	22	330
Advance payments	234	528
Accrued product warranty	194	247
Accrued other	2,078	1,313
	\$7,348	\$ 6,940

Note 10. Other Income and Expense

Other income and expense consisted of the following for the periods indicated (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Unrealized foreign exchange gain (loss)	\$ 847	\$ 183	\$ 890	\$ (2)
Realized foreign exchange gain (loss)	(160)	4	159	70
Government subsidy income	—	28	199	108
Other non-operating gain (loss)	(132)	16	9	27
Gain (loss) on disposal of assets	—	(3)	(10)	(2)
	\$ 555	\$ 228	\$ 1,247	\$ 201

Note 11. Share-Based Compensation

Equity Plans

The Company's board of directors and stockholders approved the following equity plans:

- the 1998 Share Incentive Plan
- the 2000 Share Incentive Plan
- the 2004 Share Incentive Plan
- the 2006 Share Incentive Plan
- the 2013 Equity Incentive Plan ("2013 Plan")

The Company issues stock options, restricted stock awards (“RSAs”) and restricted units (“RSUs”) to employees, consultants and non-employee directors. Stock option awards generally vest over a four year period and have a maximum term of ten years. Stock options under these plans have been granted with an exercise price equal to the fair market value on the date of the grant. Nonqualified and Incentive Stock Options, RSAs and RSUs may be granted from these plans. Prior to the Company’s initial public offering, the fair market value of the Company’s stock had been historically determined by the board of directors and from time to time with the assistance of third party valuation specialists.

Stock Options

Options have been granted to the Company’s employees under the five incentive plans and generally become exercisable as to 25% of the shares on the first anniversary date following the date of grant and semi-annually thereafter. All options expire ten years after the date of grant.

The following is a summary of option activity:

	Number of shares	Weighted Average Exercise Price	Weighted Average Share Price on Date of Exercise	Weighted Average Fair Value	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding, December 31, 2014	1,423	8.96		4.48	—	3,486
Exercised	(49)	6.95	\$ 14.09	2.37	—	347
Cancelled/Forfeited	(17)	9.82		5.23	—	35
Outstanding, June 30, 2015	1,357	\$ 9.02		\$ 4.54	7.649	\$ 11,323
Exercisable, June 30, 2015	657	\$ 8.25		\$ 3.80	7.170	\$ 5,991
Vested and expected to vest	1,299	\$ 8.97		\$ 4.51	7.626	\$ 10,896

As of June 30, 2015, there was approximately \$2.9 million of unrecognized stock option expense, net of estimated forfeitures, which is expected to be recognized over 2.13 years.

Restricted Stock Units/Awards

The following is a summary of RSU/RSA activity:

	Number of shares	Weighted Average Share Price on Date of Exercise	Weighted Average Fair Value	Aggregate Intrinsic Value
Outstanding at December 31, 2014	21		18.22	238
Granted	127		9.10	1,156
Exercised/Released	(18)	\$ 13.43	18.24	247
Cancelled/Forfeited	(2)		8.94	25
Outstanding at June 30, 2015	128		\$ 9.30	\$ 2,222
Exercisable, June 30, 2015	—			
Vested and expected to vest	123		\$ 9.29	\$ 2,127

The table above includes 57,600 RSA's granted on January 30, 2015 and issued on March 5, 2015.

As of June 30, 2015 was \$1.0 million of unrecognized compensation expense related to these RSU's and RSA's. This expense is expected to be recognized over 3.58 years.

Share-Based Compensation

Employee share-based compensation expenses recognized for the periods indicated (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Share-Based compensation - by expense type				
Cost of sales	\$18	\$28	\$34	\$53
Research and development	57	31	110	56
Sales and marketing	54	25	104	48
General and administrative	404	434	801	850
	\$533	\$518	\$1,049	\$1,007

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Share-Based compensation - by award type				
Employee stock options	\$378	\$419	\$763	\$833
Restricted stock units/awards	155	85	286	158
Warrants	—	14	—	16
	\$533	\$518	\$1,049	\$1,007

Note 12. Stockholders' Equity*Common Stock*

The Company has authorized the issuance of up to 45,000,000 shares of common stock, all of which have been designated voting common stock, under its Amended and Restated Certificate of Incorporation.

Convertible Preferred Stock

The Company has authorized the issuance of up to 5,000,000 shares of preferred stock under the Company's Amended and Restated Certificate of Incorporation.

Warrants

As of June 30, 2015 and December 31, 2014, the Company had no outstanding warrants to purchase common or preferred stock.

Public Offerings of Common Stock

On September 25, 2013, our registration statement on Form S-1 for our initial public offering was declared effective by the Securities and Exchange Commission. The offering commenced on September 26, and the Company sold 3.6 million shares of its common stock in its initial public offering at a price of \$10.00 per share, providing proceeds of \$31.5 million, net of expenses and underwriting discounts and commissions. The Company's initial public offering closed on October 1, 2013.

On March 19, 2014, the Company sold 2.0 million shares of its common stock in a secondary offering at a price of \$24.25 per share, providing proceeds of \$45.7 million, net of expenses and underwriting discounts and commissions. The Company's sale of 1.6 million shares in the secondary offering closed on March 25, 2014 and the Company's sale of an additional 0.4 million shares as a result of the underwriters' exercise of their option to purchase additional shares closed on March 28, 2014.

On June 3, 2015, the Company filed a Securities Registration Statement on Form S-3 with the Securities and Exchange Commission effective June 23, 2015, providing for the public offer and sale of certain securities of the Company from time to time, at its discretion, up to an aggregate amount of \$140 million. As of June 30, 2015, the Company has not sold any shares under this registration statement.

Note 13. Segment and Geographic Information

The Company operates in one reportable segment. The Company's Chief Executive Officer, who is considered to be the chief operating decision maker, manages the Company's operations as a whole and reviews financial information presented on a consolidated basis, accompanied by information about product revenue, for purposes of evaluating financial performance and allocating resources.

The following tables set forth the Company's revenue and asset information by geographic region. Revenue is classified based on the location of where the product is manufactured. Long-lived assets in the tables below comprise only property, plant, equipment and intangible assets (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Revenues:				
United States	\$10,960	\$6,987	\$18,254	\$12,124
Taiwan	32,908	20,549	51,249	34,889
China	5,764	5,114	10,363	10,496
	\$49,632	\$32,650	\$79,866	\$57,509

	As of the period ended	
	June 30, 2015	December 31, 2014
Long-lived assets:		
United States	\$24,524	\$ 15,875
Taiwan	40,632	35,688
China	18,578	18,008
	\$83,734	\$ 69,571

Note 14. Subsequent Events

On July 14, 2015, the Company entered into an Equity Distribution Agreement with Raymond James & Associates, Inc. (the "sales agent") pursuant to which the Company may issue and sell shares of the Company's stock having an aggregate offering price of up to \$40 million (the "ATM Offering") from time to time through the sales agent. On July 16, 2015, the Company commenced sales of common stock through the ATM Offering. As of August 5, 2015 the total gross sales were \$3.3 million and the remaining amount of common stock we have available under the ATM Offering

to sell was \$36.7 million.

On July 30, 2015, the Company's Taiwan branch fully repaid its note payable with a financing company.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q for the period ended June 30, 2015 and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the fiscal year ended December 31, 2014 included in our Annual Report on Form 10-K. References to "Applied Optoelectronics" "we," "our" and "us" are to Applied Optoelectronics, Inc. and its subsidiaries unless otherwise specified or the context otherwise requires.

This Quarterly Report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Terminology such as "believe," "may," "estimate," "continue," "anticipate," "intend," "should," "could," "would," "target," "seek," "aim," "believe," "predicts," "think," "objectives," "optimistic," "new," "goal," "strategy," "potential," "is likely," "will," "expect," "plan" "project," "permit" or by other similar expressions that convey uncertainty of future events or outcomes are intended to identify forward-looking statements.

We have based these forward-looking statements largely on our current expectations and projections about future events and industry and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in "Part II —Item 1A. Risk Factors" provided below, and those discussed in other documents we file with the SEC. Furthermore, such forward-looking statements speak only as of the date of this Quarterly Report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of this Quarterly Report.

Overview

We are a leading, vertically integrated provider of fiber-optic networking products, primarily for three networking end-markets: internet data center, cable television, or CATV, and fiber-to-the-home, or FTTH. We design and manufacture a range of optical communications products at varying levels of integration, from components, subassemblies and modules to complete turn-key equipment. In designing products for our customers, we begin with the fundamental building blocks of lasers and laser components. From these foundational products, we design and manufacture a wide range of products to meet our customers' needs and specifications, and such products differ from

each other by their end market, intended use and level of integration. We are primarily focused on the higher-performance segments within all three of our target markets, which increasingly demand faster connectivity and innovation.

The three end markets we target are all driven by significant bandwidth demand fueled by the growth of network-connected devices, video traffic, cloud computing and online social networking. To address this increased bandwidth demand, CATV and telecommunications service providers are competing directly against each other by providing bundles of voice, video and data services to their subscribers and investing to enhance the capacity, reliability and capability of their networks. The trend of rising bandwidth consumption also impacts the internet data center market, as reflected in the shift to higher speed server connections. As a result of these trends, fiber-optic networking technology is becoming essential in all three of our target markets, as it is often the only economic way to deliver the desired bandwidth.

Our vertically integrated manufacturing model provides us several advantages, including rapid product development, fast response times to customer requests and control over product quality and manufacturing costs. We design, manufacture and integrate our own analog and digital lasers using a proprietary Molecular Beam Epitaxy, or MBE, fabrication process, which we believe is unique in our industry. We manufacture the majority of the laser chips and optical components that are used in our products. The lasers we manufacture are proven to be reliable over time and highly tolerant of changes in temperature and humidity, making them well-suited to the CATV and FTTH markets where networking equipment is often installed outdoors.

We have three manufacturing sites: Sugar Land, Texas, Ningbo, China and Taipei, Taiwan. Our research and development functions are partnered with our manufacturing locations. In our U.S. facility, we manufacture laser chips (utilizing our MBE process), subassemblies and components. The subassemblies are used in the manufacture of components by our other manufacturing facilities or sold to third parties as modules. We manufacture our laser chips only within our U.S. facility, where our laser design team is located. In our Taiwan location, we manufacture optical components, such as our butterfly lasers, which incorporate laser chips, subassemblies and components manufactured within our U.S. facility. In addition, in our Taiwan location, we manufacture transceivers for the internet data center, FTTH, and other markets. In our China facility, we take advantage of lower labor costs and manufacture certain more labor intensive components and optical equipment systems, such as optical subassemblies for the internet data center market, CATV transmitters (at the headend) and CATV outdoor equipment (at the node). Each facility conducts testing on the components, modules or subsystems it manufactures and each facility is certified to ISO 9001:2008. Our China and Taiwan facilities are both certified to ISO14001:2004.

Our sales model focuses on direct engagement and close coordination with our customers to determine product design, qualifications, and performance through coordination of our sales, product engineering and manufacturing teams. Our strategy is to use our direct sales force to sell to key accounts within our markets, increasing product penetration within those customers while also growing our overall customer base in certain international and domestic markets. We have direct sales personnel in each of our U.S., Taiwan and China locations focusing on a direct and local interaction with our CATV, FTTH and internet data center customers. Throughout our sales cycle, we work closely with our customers to achieve design wins that we believe provide long-lasting relationships and promotes higher customer retention.

We have grown our revenue at a 31.7% Compound Annual Growth Rate between 2009 and 2014, including 66.3% growth year-over-year from 2013 to 2014. Our revenue growth in 2014 was driven primarily by increasing revenue from our internet data center customers. Growth in the first six months of 2015 has been driven primarily by increasing revenue from our internet data center and CATV customers.

Our principal executive offices are located at 13115 Jess Pirtle Blvd., Sugar Land, TX 77478, and our telephone number is (281) 295-1800.

Results of Operations

The following table set forth our consolidated results of operations for the periods presented and as a percentage of our revenue for those periods.

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Revenue, net	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	66.3%	65.7%	66.5%	65.5%
Gross profit	33.7%	34.3%	33.5%	34.5%
Operating expenses				
Research and development	9.5%	12.3%	11.9%	13.1%
Sales and marketing	3.2%	4.6%	4.0%	4.9%
General and administrative	9.1%	12.1%	11.9%	13.1%
Total operating expenses	21.8%	29.0%	27.8%	31.2%
Income from operations	11.9%	5.3%	5.7%	3.3%
Other income (expense)				
Interest income	0.2%	0.3%	0.2%	0.3%
Interest expense	-0.6%	-0.2%	-0.5%	-0.4%
Other expense, net	1.1%	0.7%	1.6%	0.3%
Total other expense	0.7%	0.8%	1.3%	0.2%

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Income before income taxes	12.6%	6.1%	7.0%	3.6%
Income taxes	-0.3%	-0.3%	-0.2%	-0.2%
Net income	12.3%	5.8%	6.8%	3.4%

*Comparison of Financial Results**Revenue*

We generate revenue through the sale of our products to equipment providers and network operators for the CATV, FTTH and internet data center markets. We derive a significant portion of our revenue from our top ten customers, and we anticipate that we will continue to do so for the foreseeable future. We also anticipate that our revenue derived from the internet data center market will continue to increase as a percentage of our revenue as we further penetrate and extend our products into this market. The following charts provide the revenue contribution from each of the markets we served for the three and six months ended June 30, 2015 and 2014:

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
CATV	33.1%	32.6%	35.6%	35.5%
Data Center	59.7%	54.8%	57.5%	51.3%
FTTH	2.6%	9.5%	1.8%	9.2%
Other	4.6%	3.1%	5.2%	4.0%
	100.0%	100.0%	100.0%	100.0%

	Three months ended June 30,				Six months ended June 30,			
			Change				Change	
	2015	2014	Amount	%	2015	2014	Amount	%
CATV	\$16,428	\$10,646	\$5,782	54.3%	\$28,442	\$20,394	\$8,048	39.5%
Data Center	29,610	17,899	11,711	65.4%	45,926	29,474	16,452	55.8%
FTTH	1,287	3,096	(1,809)	(58.4%)	1,409	5,312	(3,903)	(73.5%)
Other	2,307	1,009	1,298	128.6%	4,089	2,329	1,760	75.6%
Total Revenue	\$49,632	\$32,650	\$16,982	52.0%	\$79,866	\$57,509	\$22,357	38.9%

Revenues in the internet data center market were driven primarily by increasing demand for our 40 gigabits per second transceivers as our customers continued to upgrade their technology infrastructure. The decrease in revenue in our FTTH market is due to decreased demand from our major FTTH customer. The increase in revenues in the CATV market for the year was a result of revenue derived from newly-designed products that have begun to be sold in higher quantities by our customers.

For the three and six months ended June 30, 2015, our top ten customers represented 90.5% and 89.8% of our revenue, respectively.

Cost of goods sold and gross margin

	Three months ended June 30,		2014		Change	
	2015					
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(in thousands, except percentages)					
Cost of goods sold	\$32,901	66.3%	\$21,462	65.7%	\$11,439	53.3%
Gross profit/margin	\$16,731	33.7%	\$11,188	34.3%	\$5,543	49.5%

	Six months ended June 30,		2014		Change	
	2015					
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(in thousands, except percentages)					
Cost of goods sold	\$53,084	66.5%	\$37,668	65.5%	\$15,416	40.9%
Gross profit/margin	\$26,782	33.5%	\$19,841	34.5%	\$6,941	35.0%

Cost of goods sold increased by \$11.4 million, or 53.3%, from the three months ended June 30, 2014 to 2015, primarily due to a 52.0% increase in sales over the prior year. Cost of goods sold increased by \$15.4 million, or 40.9%, from the six months ended June 30, 2014 to 2015, primarily due to a 38.9% increase in sales over the prior year. Within our markets, we sell similar products in different geographic regions at different prices, resulting in different gross margins among our products. The decrease in gross margin for both the three and six months ended June 30, 2015 compared to the same periods ended June 30, 2014 were primarily the result of a product mix in our internet data center and CATV products.

Operating expenses

	Three months ended June 30,				Change	
	2015		2014			
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(in thousands, except percentages)					
Research and development	\$4,701	9.5%	\$4,009	12.3%	\$692	17.3%
Sales and marketing	1,607	3.2%	1,497	4.6%	110	7.3%
General and administrative	4,534	9.1%	3,952	12.1%	582	14.7%
Total operating expenses	\$10,842	21.8%	\$9,458	29.0%	\$1,384	14.6%

	Six months ended June 30,				Change	
	2015		2014			
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(in thousands, except percentages)					
Research and development	\$9,506	11.9%	\$7,555	13.1%	\$1,951	25.8%
Sales and marketing	3,166	4.0%	2,830	4.9%	336	11.9%
General and administrative	9,537	11.9%	7,506	13.1%	2,031	27.1%
Total operating expenses	\$22,209	27.8%	\$17,891	31.2%	\$4,318	24.1%

Research and development expense

Research and development expense increased by \$0.7 million, or 17.3%, from the three months ended June 30, 2014 compared to the three months ended June 30, 2015. Research and development expense increased by \$2.0 million, or 25.8%, from the six months ended June 30, 2014 compared to the six months ended June 30, 2015. This was primarily due to increases in personnel costs, rent and utilities, R&D work orders and project costs related to 100G data center products, DOCSIS 3.1-capable CATV products, and other new product development, and increase in depreciation expense resulting from additional R&D equipment investments. The percentage of research and development expenses over sales decreased from 12.3% to 9.5%, from the three months ended June 30, 2014 compared to the three months ended June 30, 2015. The percentage of research and development expenses over sales decreased from 13.1% to 11.9% from the six months ended June 30, 2014 compared to the six months ended June 30, 2015.

Sales and marketing expense

Sales and marketing expense increased by \$0.1 million, or 7.3%, from the three months ended June 30, 2014 compared to the three months ended June 30, 2015. Sales and marketing expense increased by \$0.3 million, or 11.9%, from the six months ended June 30, 2014 compared to the six months ended June 30, 2015. This was due to an

increase in expenses for a new sales incentive program which was implemented in May, 2014, and an increase in sales commissions directly related to our revenue growth. The percentage of sales and marketing expenses over sales decreased from 4.6% to 3.2%, from the three months ended June 30, 2014 compared to the three months ended June 30, 2015. The percentage of sales and marketing expenses over sales decreased from 4.9% to 4.0% from the six months ended June 30, 2014 compared to the six months ended June 30, 2015.

General and administrative expense

General and administrative expense increased by \$0.6 million, or 14.7%, from the three months ended June 30, 2014 compared to the three months ended June 30, 2015. General and administrative expense increased by \$2.0 million, or 27.1%, from the six months ended June 30, 2014 compared to the six months ended June 30, 2015. This was primarily due to an increase in payroll and benefits, share-based compensation expense and professional fees as well as non-recurring expenses related to the relocation of our Taiwan plant. The percentage of general and administrative expenses over sales decreased from 12.1% to 9.1%, from the three months ended June 30, 2014 compared to the three months ended June 30, 2015. The percentage of sales general and administrative expenses over sales decreased from 13.1% to 11.9% from the six months ended June 30, 2014 compared to the six months ended June 30, 2015.

Other income (expense), net

	Three months ended June 30,		2014		Change	
	2015		2014			
	Amount	% of	Amount	% of	Amount	%
		Revenue		Revenue		
	(in thousands, except percentages)					
Interest income	\$80	0.2%	\$106	0.3%	\$(26)	(24.5%)
Interest expense	(300)	(0.6%)	(60)	(0.2%)	(240)	400.0%
Other income (expense), net	555	1.1%	228	0.7%	327	143.4%
Total Other income (expense), net	\$335	0.7%	\$274	0.8%	\$61	22.3%

	Six months ended June 30,				Change	
	2015		2014			
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(in thousands, except percentages)					
Interest income	\$ 154	0.2%	\$ 185	0.3%	\$(31)	(16.8%)
Interest expense	(425)	(0.5%)	(222)	(0.4%)	(203)	91.4%
Other income (Net of expense)	1,247	1.6%	201	0.3%	1,046	520.4%
Total Other income (Net of expense)	\$ 976	1.3%	\$ 164	0.2%	\$ 812	495.1%

Interest income decreased over the same prior year periods due to lower cash and investment balances.

Interest expense increased overall for the periods due to the benefit of lower interest rates offset by new borrowing activities during the three and six months ended June 30, 2015.

Other income increased by \$0.3 million for the three months ended June 30, 2015 compared to the same period of the prior year due to \$0.7 million unrealized foreign exchange gain resulting from the fluctuation of Asia currencies against the U.S. dollar offset by \$0.2 million realized exchange loss and \$0.2 million non-recurring plant restoration expenses associated with Taiwan plant relocation.

Other income increased by \$1.0 million for the six months ended June 30, 2015 compared to the same period in 2014 due to an increase of \$0.9 million in unrealized foreign exchange gain resulting from the fluctuation of Asia currencies against the U.S. dollar, \$0.1 million from insurance claims, \$0.1 million from realized exchange gain and offset by a decrease of \$0.2 million in non-recurring plant restoration expenses. We qualify as a high-tech enterprise in China, as determined by a Chinese government, and are paid subsidies from time to time by the Chinese government to foster local high-tech manufacturing. We received \$0.1 million more subsidy in the six months ended June 30, 2015 compared to the same period in 2014.

Provision for income taxes

	Three months ended June 30,			
	2015	2014	Change	
	(in thousands, except percentages)			
Provision (benefit) for income taxes	\$(135)	\$(85)	(50)	37.0%

**Six months ended June 30,
2015 2014 Change
(in thousands, except
percentages)**

Provision (benefit) for income taxes	\$ (135)	\$ —	(135)	100.0%
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Our income tax expense for the three and six months ended June 30, 2014 consists of U.S. alternative minimum tax recorded during the periods. Due to historic losses in the U.S., our net deferred tax assets are fully offset by a deferred tax valuation allowance.

Liquidity and Capital Resources

From inception until our initial public offering, we financed our operations through private sales of equity securities, cash generated from operations and from various lending arrangements. In 2015, we entered into credit agreements with East West Bank and Comerica Bank totaling \$62.0 million to finance our working capital, campus expansion and equipment investments. In addition, we also entered various credit agreements with several Taiwan banks through our Taiwan branch totaling \$24.0 million. As of June 30, 2015, we had our unused capacity from all of our agreements of \$41.1 million. As of June 30, 2015, our cash, cash equivalents, restricted cash and short-term investments totaled \$44.3 million. Cash and cash equivalents are held for working capital purposes and are invested primarily in money market or time deposit funds. We do not enter into investments for trading or speculative purposes.

The table below sets forth selected cash flow data for the periods presented (in thousands):

	Six months ended June 30,	
	2015	2014
Net cash provided by (used in) operating activities	\$(10,586)	\$218
Net cash used in investing activities	(23,171)	(17,108)
Net cash provided by financing activities	30,880	29,021
Effect of exchange rates on cash and cash equivalents	(886)	(58)
Net increase (decrease) in cash and cash equivalents	\$(3,763)	\$12,073

Operating activities

For the six months ended June 30, 2015, net cash used in operating activities was \$10.6 million. During the six months ended June 30, 2015, we recorded net income of \$5.4 million. The net income included non-cash charges, including depreciation and amortization of \$4.3 million, share-based compensation and warrant expense of \$1.0 million and non-cash increases to our inventory reserve account of \$1.3 million. Cash used in operating activities primarily related to an increase in inventory related to sales orders, an increase in our accounts receivable from the sale of our products, offset by cash provided by an increase in accounts payable to our vendors.

For the six months ended June 30, 2014, net cash used in operating activities was \$0.2 million. During the six months ended June 30, 2014, we recorded net income of \$2.0 million. The net income included non-cash charges, including depreciation and amortization of \$2.7 million, share-based compensation and warrant expense of \$1.0 million and non-cash increases to our inventory reserve account of \$0.8 million. Cash used in operating activities primarily related to an increase in accounts receivable from the sale of our products and an increase in inventory related to sales orders, offset by cash provided by an increase in accounts payable to our vendors and an increase in accrued liabilities.

Investing activities

For the six months ended June 30, 2015, net cash used in investing activities was \$23.2 million, \$17.4 million for the purchase of additional machinery and equipment and investment in construction of our U.S. plant and \$5.1 million used to increase restricted cash related to an escrow account required for construction.

For the six months ended June 30, 2014, net cash used in investing activities was \$17.1 million for the purchase of additional machinery and equipment and the payment for intellectual property licenses to support new product

development efforts and manufacturing activities.

Financing activities

Our financing activities consisted primarily of proceeds from the issuance of common stock and activity associated with our various lending arrangements.

For the six months ended June 30, 2015, our financing activities provided \$30.1 million in cash. We received \$31.6 million in net borrowings associated with our bank loans, \$1.4 million in net proceeds from acceptance payable, offset by increased restricted cash of \$2.0 million related to our bank loan requirements.

For the six months ended June 30, 2014, our financing activities provided \$29.0 million in cash. We received \$45.6 million in net proceeds from a secondary offering of common stock. This increase was offset by the repayment of \$16.5 million in net borrowings associated with our bank loans.

Loans and commitments

We have lending arrangements with several financial institutions, including a revolving line of credit and a term loan with East West Bank and Comerica Bank in the U.S., lines of credit and financing agreements for our Taiwan branch and several lines of credit arrangements for our China subsidiary. As of June 30, 2015, we had \$41.1 million of unused borrowing capacity.

On June 30, 2015, we entered into with East West Bank and Comerica Bank a credit agreement, a second lien deed of trust, multiple security agreements and promissory notes evidencing two credit facilities and a term loan. The credit agreement included a \$25.0 million revolving line of credit which matures on June 30, 2018 and a \$10 million term loan maturing on June 30, 2020. The interest rate on these loans is the LIBOR Borrowing Rate plus 2.75% or 3.0%. As of June 30, 2015, \$25.0 million was outstanding under the revolving line of credit and \$2.0 million was outstanding under the term loans.

Also with East West Bank was a term loan of \$5 million with monthly payments of principal and interest that matures on July 31, 2019. As of June 30, 2015, the outstanding balance of such term loan was \$4.6 million.

On January 26, 2015, we entered into a construction loan agreement with East West Bank for up to \$22.0 million dollars to finance the construction of our campus expansion plan in Sugar Land, Texas. Upon signing the agreement, we deposited \$11.0 million into a restricted bank account for owner's contribution of construction costs. The loan will have a fifteen month draw down period with monthly interest payments commencing on February 26, 2015 and ending April 26, 2016. Thereafter, the entire outstanding principal balance shall be converted to a sixty-nine month term loan with principal and interest payments due monthly amortized over three hundred months. The first principal and interest payment is due on May 26, 2016 and will continue the same day of each month thereafter. The final principal and interest payment is due on January 26, 2022 and will include all unpaid principal and all accrued and unpaid interest. We may pay without penalty all or a portion of the amount owed earlier than due. Under the loan agreement, the loan bears interest, at an annual rate based on the one-month LIBOR Borrowing Rate plus 2.75%. As of June 30, there were no amounts outstanding under this loan agreement and there was a balance of \$5.1 million in the restricted bank account..

Our loan and security agreements with East West Bank and Comerica Bank require us to maintain certain financial covenants, including a minimum current ratio and minimum annual EBITDA. As of June 30, 2015, we were in compliance with all covenants contained in these agreements.

On January 6, 2015, our Taiwan branch entered into a Credit Facility with CTBC Bank Co. Ltd. in Taipei, Taiwan for 90.0 million New Taiwan dollar (\$3.0 million USD), one year revolving credit facility. Our obligations under the Credit Facility are unsecured. Borrowings under the Credit Facility will bear interest at a rate based on the Bank's corporate interest rate index plus 1.5%, adjusted monthly. As of the execution of the Credit Facility the Bank's corporate interest rate index is 0.91%. As of June 30, 2015, \$2.3 million was outstanding under this credit facility.

On March 9, 2015, our Taiwan branch increased its \$4.0 million, to a \$7.0 million revolving credit facility with E. Sun Commercial Bank. Our obligations under the credit facility are secured by our \$4.0 million cash deposit in a one-year CD with such bank and mature on May 27, 2016. The \$4.0 million revolving line of credit with CD security bears interest at a rate equal to Taiwan Deposit Index Rate plus 0.38% for New Taiwan Dollar borrowings and a 0.1% service fee for U.S. dollar borrowings. The additional \$3.0 million credit facility bears interest at a rate equal to

LIBOR plus 1.7% divided by 0.946 and a 0.5% service fee for U.S. dollar borrowings. As of June 30, 2015, \$5.9 million was outstanding under this credit facility.

On March 25, 2015, our Taiwan branch renewed its \$4.0 million, one year revolving credit facility agreement, originally dated December 31, 2013, with Mega International Commercial Bank. Our obligations under the credit facility are secured by our \$4.0 million cash deposit in a CD with such bank. Borrowings under this credit facility will bear interest at a rate not less than the LIBOR borrowing rate plus 1.0%, divided by 0.946 for U.S. dollar borrowings, New Taiwan Dollar borrowings interest will bear at a rate equal to the Bank's base lending rate plus 0.76%. The current effective interest rate is 1.77%. As of June 30, 2015, \$3.6 million was outstanding under this credit facility.

On April 1, 2015, our Taiwan branch entered into a comprehensive credit line agreement with the Taipei branch of China Construction Bank, providing a revolving credit line of \$3.0 million, maturing on April 1, 2016. Borrowings under the credit line agreement are secured by a standby letter of credit issued by the China branch of the bank under existing agreements between the bank and our China subsidiary. Borrowings under the credit line agreement reduce the amounts available under of the existing credit line between the bank and our China subsidiary and cannot exceed 97% of the amount of the standby letter of credit issued by the China branch of the bank. Borrowings under the credit line agreement will bear interest at a rate not less than LIBOR plus 1.5% for US dollar borrowings and at a rate of not less than Taiwan Interbank Offered Rate plus 0.9% for New Taiwan dollar borrowings. As of June 30, 2015, \$2.9 million was outstanding under this credit facility.

Our Taiwan branch had an outstanding note payable balance of \$0.1 million with a financing company that matures on July 30, 2015.

On June 30, 2015, our Taiwan branch entered into a purchase and sale contract and a finance lease agreement together with the sale contract with Chailease Finance Co, Ltd. in connection with certain equipment, structured as a sale lease-back transaction. Pursuant to the sale contract, we sold certain equipment to Chailease and simultaneously leased the equipment back from Chailease pursuant to the finance lease agreement. The finance lease agreement has a three year term, with monthly lease payments, maturing on May 27 and June 30, 2018, respectively. The title to the equipment will be transferred to us upon the expiration of the finance lease agreement. As of June 30, 2015, \$6.2 million was outstanding under this finance lease agreement.

As of June 30, 2015, our China subsidiary had credit facilities with China Construction Bank totaling \$12.1 million, which can be drawn in U.S. currency, RMB currency or issuing bank acceptance notes to vendors with different interest rates. As of June 30, 2015, we had a U.S. currency based loan of \$4.0 million outstanding under various notes with three-month terms, maturing from July 2015 to September 2015 with effective interest rate of 3.15%. There was \$3.9 million outstanding RMB currency cash loan as of June 30, 2015, with a maturity date of April 26, 2016. The effective interest rate for the RMB currency loan was 5.79%. The outstanding balance of bank acceptance notes issued to vendors was \$2.7 million with zero interest rate as of June 30, 2015.

A customary business practice in China is for customers to exchange accounts receivable with notes receivable issued by their bank. From time to time we accept notes receivable from certain of our customers in China. These notes receivable are non-interest bearing and are generally due within nine months, and such notes receivable may be redeemed with the issuing bank prior to maturity at a discount. Historically, we have collected on the notes receivable in full at the time of maturity.

Frequently, we also direct our banking partners to issue bank acceptance notes payable to our suppliers in China in exchange for accounts payable. Our China subsidiary's banks issue the notes to vendors and issue payment to vendors upon redemption. We owe the payable balance to the issuing bank. The notes payable are non-interest bearing and are generally due within nine months of issuance. As a condition of the notes payable lending arrangements, we are required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the notes payable are paid by our China subsidiary. These balances are classified as restricted cash on our consolidated balance sheets.

Future liquidity needs

We believe that our existing cash and cash equivalents, and cash flows from our operating activities, will be sufficient to meet our anticipated cash needs for the next 12 months. Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support our research and development efforts, the expansion of our sales and marketing activities, the introduction of new and enhanced products, the expansion of our manufacturing capacity and the continuing market acceptance of our products. In the event that additional liquidity is required to meet our long-term investments, we may need to explore additional sources of liquidity by additional bank credit facilities or raising capital through additional equity or debt financing. The sale of additional equity or debt security could result in additional dilution to our stockholders, and its terms and prices may not be acceptable to us. If we are unable to raise additional capital when desired, our business, operating results and financial condition would be adversely affected.

At-The-Market Offering

On June 3, 2015, we filed a Securities Registration Statement on Form S-3 with the Securities and Exchange Commission effective June 23, 2015, providing for the public offer and sale of certain securities of the Company from time to time up to an aggregate amount of \$140 million.

On July 14, 2015, we entered into an Equity Distribution Agreement (the “Distribution Agreement”) with Raymond James & Associates, Inc. (the “Sales Agent”) pursuant to which we may issue and sell shares of the Company’s common stock, par value \$0.001 per share (the “Shares”), having an aggregate offering price of up to \$40 million (the “ATM Offering”) from time to time through the Sales Agent. Upon delivery of a placement notice and subject to the terms and conditions of the Distribution Agreement, sales, if any, of the Shares will be made through the Sales Agent in transactions that are deemed to be “at the market” offerings as defined in Rule 415 of the Securities Act of 1933, as amended (the “Securities Act”), including sales made through the facilities of the NASDAQ Global Market, the principal trading market for the Company’s common stock, on any other existing trading market for the Company’s common stock, to or through a market maker or as otherwise agreed by the Company and the Sales Agent. In the placement notice, the Company will designate the maximum number of Shares to be sold through the Sales Agent, the time period during which sales are requested to be made, the minimum price for the Shares to be sold, and any limitation on the number of Shares that may be sold in any one day. Subject to the terms and conditions of the Distribution Agreement, the Sales Agent will use its commercially reasonable efforts to sell Shares on the Company’s behalf up to the designated amount specified in the placement notice. We have no obligation to sell any Shares under the Agreement and may at any time suspend offers and sales of the Shares under the Distribution Agreement.

The Agreement provides that the Sales Agent will be entitled to compensation of up to 2.5% of the gross sales price of the Shares sold through the Sales Agent from time to time. We have also agreed to reimburse the Sales Agent for certain specified expenses in connection with the registration of Shares under state blue sky laws and any filing with, and clearance of the offering by, the Financial Industry Regulatory Authority Inc., not to exceed \$10,000 in the aggregate, and any associated application fees incurred. Additionally, if the Agreement is terminated under certain circumstances, and we fail to sell a minimum amount of the Shares as set forth in the Agreement, then the Company has agreed to reimburse the Sales Agent for reasonable out-of-pocket expenses, including the reasonable fees and disbursements of counsel incurred by the Sales Agent, up to a maximum of \$50,000 in the aggregate. We agreed to indemnify the Sales Agent against certain liabilities, including liabilities under the Securities Act, or to contribute to payments that the Sales Agent may be required to make because of any of those liabilities.

In July 2015, we commenced sales of common stock through the ATM Offering. The details of the shares of common stock sold through the ATM Offering through August 5, 2015 are as follows (dollars in thousands, except per share data):

Distribution Agent	Month	Weighted Average Per Share Price	Number of Shares Sold	Net Proceeds	Compensation to Distribution Agent
Raymond James & Associates, Inc.	July 2015	\$ 19.33	171	\$ 3,220	\$ 83

As of August 5, 2015, the total gross sales were \$3.3 million and the remaining amount of common stock we have available under the ATM Offering to sell was \$36.7 million.

Contractual Obligations and Commitments

The following summarizes our contractual obligations as of June 30, 2015 (in thousands):

	Payments due by period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt ⁽¹⁾	\$60,586	\$30,990	\$ 27,370	\$ 2,226	\$—
Bank acceptance payable ⁽¹⁾	2,660	2,660	—	—	—
Operating leases ⁽²⁾	14,514	1,156	2,662	2,033	8,663

Total commitments	\$77,760	\$34,806	\$30,032	\$4,259	\$8,663
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We have several loan and security agreements in China, Taiwan and the U.S. that provide various credit facilities, (1) including lines of credit, term loans and bank acceptance notes. The amount presented in the table represents the principal portion of the obligations.

(2) We have entered into various non-cancellable operating lease agreements for our offices in Taiwan and the U.S.

Off-Balance Sheet Arrangements

For the three and six months ended June 30, 2015, we did not, and we do not currently, have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

In our annual report on Form 10-K for the year ended December 31, 2014, we identified our most critical accounting policies. In preparing the financial statements, we make assumptions, estimates and judgments that affect the amounts reported. We periodically evaluate our estimates and judgments that are most critical in nature which are related to revenue recognition under long-term construction contracts; allowance for doubtful accounts; inventory reserves; impairment of long-lived assets (excluding goodwill and other indefinite-lived intangible assets); goodwill and other indefinite-lived intangible assets; purchase price allocation of acquisitions; service and product warranties; and income taxes. Our estimates are based on historical experience and on our future expectations that we believe are reasonable. The combination of these factors forms the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results are likely to differ from our current estimates and those differences may be material.

JOBS Act

The Jumpstart Our Business Startups Act of 2012, or JOBS Act, contains provisions that, among other things, reduce certain reporting requirements for qualifying public companies. As defined in the JOBS Act, a public company whose initial public offering of common equity securities occurred after December 8, 2011 and whose annual gross revenues are less than \$1.0 billion will, in general, qualify as an “emerging growth company” until the earliest of:

- the last day of its fiscal year following the fifth anniversary of the date of its initial public offering of common equity securities;

- the last day of its fiscal year in which it has annual gross revenue of \$1.0 billion or more;

- the date on which it has, during the previous three-year period, issued more than \$1.0 billion in non-convertible debt; and

- the date on which it is deemed to be a “large accelerated filer,” which will occur at such time as the company (a) has an aggregate worldwide market value of common equity securities held by non-affiliates of \$700 million or more as of the last business day of its most recently completed second fiscal quarter, (b) has been required to file annual and quarterly reports under the Exchange Act for a period of at least 12 months and (c) has filed at least one annual report pursuant to the Securities Act of 1934, as amended.

Under this definition, we are an “emerging growth company” and could remain one until as late as December 31, 2018.

As an “emerging growth company” we have chosen to rely on such exemptions and are therefore not required to, among other things, (i) provide an auditor’s attestation report on our system of internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act, (ii) provide all of the compensation disclosure that may be required of non-emerging growth public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act, (iii) comply with any requirement that may be adopted by the Public Company Accounting Oversight Board, or PCAOB, regarding mandatory audit firm rotation or a supplement to the auditor’s report providing additional information about the audit and the financial statements (auditor discussion and analysis) and (iv) disclose certain executive compensation-related items such as the correlation between executive compensation and performance and comparisons of the Chief Executive Officer’s compensation to median employee compensation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risks

Market risk represents the risk of loss that may impact our financial statements through adverse changes in interest rates, foreign exchange rates and inflation. Our market risk exposure results primarily from fluctuations in foreign exchange rates. We manage our exposure to these market risks through our regular operating and financing activities. We have not historically attempted to reduce our market risks through hedging instruments; we may, however, do so in the future.

Interest Rate Fluctuation Risk

Our cash equivalents consisted primarily of money market funds, and interest and non-interest bearing bank deposits. Our primary objective is to maintain the security of our principal balances and ensure liquidity. We attempt to maximize the return on these balances without significantly increasing risk, but have little opportunity to do so given the short-term nature of our investments and current interest rate environments. We do not anticipate any material effect on our cash balances or investment portfolio due to fluctuations in interest rates.

We are exposed to market risk due to the possibility of changing interest rates associated with certain debt instruments. As of June 30, 2015, our U.S. debt bears a variable rate of interest that is based on LIBOR. The debt subject to variable rates is subject to fluctuation in the LIBOR. As of June 30, 2015, the interest on our China debt varied based on when each term loan is drawn. Once drawn the interest remains fixed for the term of that draw. As of June 30, 2015, we had not hedged our interest rate risk.

With respect to our interest expense for the three months ended June 30, 2015, an increase of 1.0% in each of our interest rates would have resulted in an increase of \$0.6 million in our interest expense for such period.

Foreign Exchange Rates

We operate on an international basis with a portion of our revenue and expenses being incurred in currencies other than the U.S. dollar. Fluctuations in the value of these foreign currencies in which we conduct our business relative to the U.S. dollar affects our results and will cause U.S. dollar translation of such currencies to vary from one period to another. We cannot predict the effect of exchange rate fluctuations upon our future operating results. The effect on our results of operations from currency fluctuations is reduced, because we have revenue and expenses in each of these foreign currencies. We maintain certain assets, including certain bank accounts, accounts receivables, land and building, in RMB and the NT dollar, which are sensitive to foreign currency exchange rate fluctuations. Certain of our current and long-term liabilities are denominated in these currencies. Additionally, the value of the RMB against the U.S. dollar and other currencies fluctuates and is affected by, among other things, changes in political and economic conditions in China. Under China's current exchange rate regime, the RMB may appreciate or depreciate significantly

in value against the U.S. dollar in the medium to long term.

We use the U.S. dollar as our functional and reporting currency for our financial statements. All transactions in currencies other than the U.S. dollar during the year are re-measured at the exchange rates prevailing on the respective relevant dates of such transactions. Monetary assets and liabilities existing at the balance sheet date denominated in currencies other than the U.S. dollar are re-measured at the exchange rates prevailing on such date. Exchange differences are recorded in our consolidated income statement. The financial records of our China subsidiary and our Taiwan branch are maintained in their respective local currencies, the RMB and the NT dollar, which are the functional currencies for our China subsidiary and our Taiwan branch, respectively. Assets and liabilities are translated at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates and revenues, expenses, gains and losses are translated using the average rate for the then current period using a monthly average. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of accumulated other comprehensive income in our statement of stockholders' equity (deficit) and comprehensive income. Transaction gains and losses are recognized in our statements of operations in other income (expense).

During the three months ended June 30, 2015, 4.0% of our revenue was denominated in RMB and less than 1% of revenue was denominated in NT dollars. In the three months ended June 30, 2015, 17.1% of our operating expenses were denominated in RMB and 32.1% of our operating expenses were denominated in NT dollars. Accordingly, fluctuations in exchange rates directly affect our cost of goods sold and net income, and have a significant impact on our operating margins. If exchange rates for RMB and NT dollars for U.S. dollars were 1% higher during the three months ended June 30, 2015, our operating expenses would have been higher by \$0.1 million.

As of June 30, 2015, we held the U.S. dollar equivalent of approximately \$10.8 million in RMB and \$3.2 million in NT dollars, including cash and cash equivalents. With respect to our cash and cash equivalents as of June 30, 2015, a 1.0% change in the exchange rates between the RMB and the U.S. dollar or the NT dollar and the U.S. dollar would result in an immaterial change in our total cash and cash equivalents.

During the three months ended June 30, 2015, we recognized a \$0.7 million foreign currency transaction gain.

Inflation

We believe that the relatively low rate of inflation in the U.S. over the past few years has not had a significant impact on our sales or operating results or on the prices of raw materials. However, an increase in the rate of inflation in the future may have an adverse effect on our levels of gross profit if material prices rise and if sales prices for our products do not proportionately increase. Changes in the proportion of our operations in China or Taiwan may result in the rate of inflation having a more significant impact on our operating results in the future.

Item 4. Controls and Procedures

The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2015, the end of the period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of such date.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three month period covered by this Quarterly Report on Form 10-Q, which were identified in connection with management’s evaluation required by the Rules 13a-15(d) and 15d-15(d) under the Exchange Act that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

As of June 30, 2015, we were not involved in any material pending legal proceedings.

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors and all other information contained in this Quarterly Report on Form 10-Q, including our condensed consolidated financial statements and related notes. If any of the following risks actually occur, we may be unable to conduct our business as currently planned and our financial condition and results of operations could be seriously harmed. In addition, the trading price of our common stock could decline due to the occurrence of any of these risks and you may lose all or part of your investment.

Risks Inherent in Our Business

We are dependent on our key customers for a significant portion of our revenue and the loss of, or a significant reduction in orders from, any of our key customers would adversely impact our revenue and results of operations.

We generate much of our revenue from a limited number of customers. In the six months ended June 30, 2015 and years ended December 31, 2014, 2013 and 2012, our top ten customers represented 89.8%, 87.2%, 76.9%, and 77.6% of our revenue, respectively. In 2014, Amazon represented 45.8% of our revenue, Cisco Systems, Inc. represented 8.9% of our revenue and a leading internet service provider represented 6.7% of our total revenue. As a result, the loss of, or a significant reduction in orders from any of our key customers would materially and adversely affect our revenue and results of operations. We typically do not have long-term contracts with our customers and instead rely on recurring purchase orders. If our key customers do not continue to purchase our existing products or fail to purchase additional products from us, our revenue would decline and our results of operations would be adversely affected.

Adverse events affecting our key customers could also negatively affect our ability to retain their business and obtain new purchase orders, which could adversely affect our revenue and results of operations. For example, in recent years,

there has been consolidation among various network equipment manufacturers and this trend is expected to continue. We are unable to predict the impact that industry consolidation would have on our existing or potential customers. We may not be able to offset any potential decline in revenue arising from the consolidation of our existing customers with revenue from new customers or additional revenue from the merged company.

If our customers do not qualify our products for use on a timely basis, our results of operations may suffer.

Prior to the sale of new products, our customers typically require us to obtain their approval and qualify our products for use in their applications. Additionally, new customers often audit our manufacturing facilities and perform other evaluations during this process. The qualification process involves product sampling and reliability testing and collaboration with our product management and engineering teams in the design and manufacturing stages. If we are unable to accurately predict the amount of time required to qualify our products with customers, or are unable to qualify our products with certain customers at all, then our ability to generate revenue could be delayed or our revenue would be lower than expected and we may not be able to recover the costs associated with the qualification process or with our product development efforts, which would have an adverse effect on our results of operations.

In addition, due to rapid technological changes in our markets, a customer may cancel or modify a design project before we have qualified our product or begun volume manufacturing of a qualified product. It is unlikely that we would be able to recover the expenses for cancelled or unutilized custom design projects. Some of these unrecoverable expenses for cancelled or unutilized custom design projects may be significant. It is difficult to predict with any certainty whether our customers will delay or terminate product qualification or the frequency with which customers will cancel or modify their projects, but any such delay, cancellation or modification would have a negative effect on our results of operations.

Our ability to successfully qualify and scale capacity for new technologies and products is important to our ability to grow our business and market presence, and we may invest a significant amount to scale our capacity to meet potential demand from customers for our new technologies and products. If we are unable to qualify and sell any of our new products in volume, on time, or at all, our results of operations may be adversely affected.

We must continually develop successful new products and enhance existing products, and if we fail to do so or if our release of new or enhanced products is delayed, our business may be harmed.

The markets for our products are characterized by frequent new product introductions, changes in customer requirements and evolving industry standards, all with an underlying pressure to reduce cost and meet stringent reliability and qualification requirements. Our future performance will depend on our successful development, introduction and market acceptance of new and enhanced products that address these challenges. If we are unable to make our new or enhanced products commercially available on a timely basis, we may lose existing and potential customers and our financial results would suffer.

In addition, due to the costs and length of research, development and manufacturing process cycles, we may not recognize revenue from new products until long after such expenditures, if at all, and our margins may decrease if our costs are higher than expected, adversely affecting our financial condition and results of operation.

Although the length of our product development cycle varies widely by product and customer, it may take 18 months or longer before we receive our first order. As a result, we may incur significant expenses long before customers accept and purchase our products.

Product development delays may result from numerous factors, including:

- modification of product specifications and customer requirements;
- unanticipated engineering complexities;
- difficulties in reallocating engineering resources and overcoming resource limitations; and
- rapidly changing technology or competitive product requirements.

The introduction of new products by us or our competitors could result in a slowdown in demand for our existing products and could result in a write-down in the value of our inventory. We have in the past experienced a slowdown in demand for existing products and delays in new product development, and such delays will likely occur in the future. To the extent we experience product development delays for any reason or we fail to qualify our products and obtain their approval for use, which we refer to as a design win, our competitive position would be adversely affected and our ability to grow our revenue would be impaired.

Furthermore, our ability to enter a market with new products in a timely manner can be critical to our success because it is difficult to displace an existing supplier for a particular type of product once a customer has chosen a supplier, even if a later-to-market product provides better performance or cost efficiency.

The development of new, technologically advanced products is a complex and uncertain process requiring frequent innovation, highly-skilled engineering and development personnel and significant capital, as well as the accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product introductions by competitors, technological changes or emerging industry standards. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, license these technologies from third parties, or remain competitive in our markets.

Customer demand is difficult to forecast accurately and, as a result, we may be unable to match production with customer demand.

We make planning and spending decisions, including determining the levels of business that we will seek and accept, production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimates of product demand and customer requirements. Our products are typically purchased pursuant to individual purchase orders. While our customers may provide us with their demand forecasts, they are typically not contractually committed to buy any quantity of products beyond firm purchase orders. Furthermore, many of our customers may increase, decrease, cancel or delay purchase orders already in place without significant penalty. The short-term nature of commitments by our customers and the possibility of unexpected changes in demand for their products reduce our ability to accurately estimate future customer requirements. On occasion, customers may require rapid increases in production, which can strain our resources, cause our manufacturing to be negatively impacted by materials shortages, necessitate more onerous procurement commitments and reduce our gross margin. We may not have sufficient capacity at any given time to meet the volume demands of our customers, or one or more of our suppliers may not have sufficient capacity at any given time to meet our volume demands. If any of our major customers decrease, stop or delay purchasing our products for any reason, we will likely have excess manufacturing capacity or inventory and our business and results of operations would be harmed.

We are subject to the cyclical nature of the markets in which we compete and any future downturn will likely reduce demand for our products and revenue.

In each of our target markets, including the CATV market, our sales depend on the aggregate capital expenditures of service providers as they build out and upgrade their network infrastructure. These markets are highly cyclical and characterized by constant and rapid technological change, price erosion, evolving standards and wide fluctuations in product supply and demand. In the past, these markets have experienced significant downturns, often connected with, or in anticipation of, the maturation of product cycles. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. Our historical results of operations have been subject to these cyclical fluctuations, and we may experience substantial period-to-period fluctuations in our future results of operations. Any future downturn in any of the markets in which we compete could significantly reduce the demand for our products and therefore may result in a significant reduction in our revenue. Our revenue and results of operations may be materially and adversely affected in the future due to changes in demand from individual customers or cyclical changes in any of the markets utilizing our products. We may not be able to accurately predict these cyclical fluctuations and the impact of these fluctuations may have on our revenue and operating results.

The market for fiber-optic products in the internet data center market is relatively new and our business could be harmed if this market does not continue to develop as we expect

In the internet data center market, we are relying on the emergence of new internet data center providers and their adoption of open internet data center architectures that use a mix of systems and components from a variety of vendors, including non-traditional equipment vendors. Internet data center operators may instead elect to use traditional equipment vendors, which often require internet data center operators to purchase the optical modules for their systems from such larger vendors. Also, internet data centers may not expand as much or as quickly as expected and any slowdown in expansion could adversely impact our business and growth prospects. If our expectations for the growth of the internet data center market are not realized, our financial condition or results of operations will be adversely affected.

If the CATV market does not continue to develop as we expect, or if there is any downturn in this market, our business would be adversely affected.

Historically, we have generated much of our revenue from the CATV market. In 2014, 2013 and 2012, the CATV market represented 36.3%, 60.4% and 78.6% of our revenue, respectively. In the CATV market, we are relying on expected increasing demand for bandwidth-intensive services and applications such as on-demand television programs, high-definition television channels, or HDTV, social media, peer-to-peer file sharing and online video creation and viewing from network service providers. Without network and bandwidth growth, the need for our products will not increase and may decline, adversely affecting our financial condition and results of operations. Although demand for broadband access is increasing, network and bandwidth growth may be limited by several factors, including an uncertain regulatory environment, high infrastructure costs to purchase and install equipment and uncertainty as to which competing content delivery solution, such as telecommunications, wireless or satellite, will gain the most widespread acceptance. CATV network operators may reduce or forego equipment purchases in anticipation of the availability of next generation DOCSIS 3.1 solutions that are expected to be available soon, which may adversely affect our sales. If the trend of outsourcing for the design and manufacture of CATV equipment does not continue, or continues at a slower pace than currently expected, our customers' demand for our design and manufacturing services may not grow as quickly as expected. If expectations for the growth of the CATV market are not realized, our financial condition or results of operations will be adversely affected. In addition, if the CATV market is adversely impacted, whether due to competitive pressure from telecommunication service providers, regulatory changes, or otherwise, our business would be adversely affected. We may not be able to offset any potential decline in revenue from the CATV market with revenue from new customers in other markets.

We have limited operating history in the FTTH market, and our business could be harmed if this market does not develop as we expect.

For 2014, we generated 10.4% of our revenue from the FTTH market. We have only recently begun offering products to the FTTH market, and our business in this market has been largely dependent on a single customer who has not recently placed any orders for FTTH products from us. Our business in this market is dependent on the deployment of our optical components, modules and subassemblies. In this market, we are relying on increasing demand for bandwidth-intensive services and telecommunications service providers' acceptance and deployment of WDM-PON as a technology supporting 1 gigabit per second service to the home. Without network and bandwidth growth and adoption of our solutions by operators in these markets, we will not be able to sell our products in these markets in high volume or at our targeted margins, which would adversely affect our financial condition and results of operations. For example, WDM-PON technology may not be adopted by equipment and service providers in the FTTH market as rapidly as we expect or in the volumes we need to achieve acceptable margins.

If we encounter manufacturing problems, we may lose sales and damage our customer relationships.

We may experience delays, disruptions or quality control problems in our manufacturing operations. These and other factors may cause less than acceptable yields at our wafer fabrication facility. Manufacturing yields depend on a number of factors, including the quality of available raw materials, the degradation or change in equipment calibration and the rate and timing of the introduction of new products. Changes in manufacturing processes required as a result of changes in product specifications, changing customer needs and the introduction of new product lines may significantly reduce our manufacturing yields, resulting in low or negative margins on those products. In addition, we use an MBE fabrication process to make our lasers, rather than Metal Organic Chemical Vapor Deposition, or MOCVD, the technique most commonly used in optical manufacturing by communications optics vendors, and our Molecular Beam Epitaxy, or MBE, fabrication process relies on custom-manufactured equipment. If our MBE fabrication facility in Sugar Land, Texas were to be damaged or destroyed for any reason, our manufacturing process would be severely disrupted. Any such manufacturing problems would likely delay product shipments to our customers, which would negatively affect our sales, competitive position and reputation. We may also experience delays in production, typically in February, during the Chinese New Year holiday when our facilities in China and Taiwan are closed.

Increasing costs and shifts in product mix may adversely impact our gross margins.

Our gross margins on individual products and among products fluctuate over each product's life cycle. Our overall gross margins have fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices and our ability to reduce product costs, and these fluctuations are expected to continue in the future. We may not be able to accurately predict our product mix from period to period, and as a result we may not be able to forecast accurately our overall gross margins. The rate of increase in our costs and expenses may exceed the rate of increase in our revenue, either of which would materially and adversely affect our business, our results of operations and our financial condition.

Given the high fixed costs associated with our vertically integrated business, a reduction in demand for our products will likely adversely impact our gross profits and our results of operations.

We have a high fixed cost base due to our vertically integrated business model, including the fact that 1,206 of our employees as of December 31, 2014 were employed in manufacturing and research and development operations. We may not be able to adjust these fixed costs quickly to adapt to rapidly changing market conditions. Our gross profit and gross margin are greatly affected by our sales volume and volatility on a quarterly basis and the corresponding absorption of fixed manufacturing overhead expenses. In addition, because we are a vertically integrated manufacturer, insufficient demand for our products may subject us to the risk of high inventory carrying costs and increased inventory obsolescence. Given our vertical integration, the rate at which we turn inventory has historically been low when compared to our cost of sales. We do not expect this to change significantly in the future and believe that we will have to maintain a relatively high level of inventory compared to our cost of sales. As a result, we continue to expect to have a significant amount of working capital invested in inventory. We may be required to write down inventory costs in the future and our high inventory costs may have an adverse effect on our gross profits and our results of operations.

We face intense competition which could negatively impact our results of operations and market share.

The markets into which we sell our products are highly competitive. Our competitors range from large, international companies offering a wide range of products to smaller companies specializing in niche markets. Current and potential competitors may have substantially greater name recognition, financial, marketing, research and manufacturing resources than we do, and there can be no assurance that our current and future competitors will not be more successful than us in specific product lines or markets. Some of our competitors may also have better-established relationships with our current or potential customers. Some of our competitors have more resources to develop or acquire new products and technologies and create market awareness for their products and technologies. In addition, some of our competitors have the financial resources to offer competitive products at below-market pricing levels that could prevent us from competing effectively and result in a loss of sales or market share or cause us to lower prices for our products. In recent years, there has been consolidation in our industry and we expect such consolidation to

continue. Consolidation involving our competitors could result in even more intense competition. Network equipment manufacturers, who are our customers, and network service providers may decide to manufacture the optical subsystems incorporated into their network systems in-house instead of outsourcing such products to companies such as us. We also encounter potential customers that, because of existing relationships with our competitors, are committed to the products offered by our competitors.

We have a history of losses and have a substantial accumulated deficit.

We have a history of losses and have a substantial accumulated deficit. In the years ended December 31, 2013 and 2012, we experienced net losses of \$1.4 million and \$0.9 million, respectively. In the six months ended June 30, 2015 and year ended December 31, 2014, we experienced profits of \$6.1 and \$4.3 million, respectively. As of June 30, 2015 and December 31, 2014 and 2013, our accumulated deficit was \$73.6 million, \$79.0 million and \$83.3 million, respectively. These losses were due to expenditures made to expand our business, including expenditures for hiring additional research and development, and sales and marketing personnel, and expenditures to expand and maintain our manufacturing facilities and research and development operations. We expect to continue to make significant expenditures related to our business, including expenditures for hiring additional research and development, and sales and marketing personnel, and expenditures to maintain and expand our manufacturing facilities and research and development operations. In addition, we have incurred significant additional time demands and legal, accounting and other expenses since we became a public company in September 2013. Our management and other personnel devote a substantial amount of time to complying with the applicable rules and requirements of being a public company.

Our financial results may vary significantly from quarter-to-quarter due to a number of factors, which may lead to volatility in our stock price.

Our quarterly revenue and operating results have varied in the past and will likely continue to vary significantly from quarter to quarter. This variability may lead to volatility in our stock price as research analysts and investors respond to these quarterly fluctuations. These fluctuations are due to numerous factors, including:

- the timing, size and mix of sales of our products;
- fluctuations in demand for our products, including the increase, decrease, rescheduling or cancellation of significant customer orders;
- our ability to design, manufacture and deliver products to our customers in a timely and cost-effective manner and that meet customer requirements;
- new product introductions and enhancements by us or our competitors;
- the gain or loss of key customers;
- the rate at which our present and potential customers and end users adopt our technologies;
- changes in our pricing and sales policies or the pricing and sales policies of our competitors;
- quality control or yield problems in our manufacturing operations;
- supply disruption for certain raw materials and components used in our products;
- capacity constraints of our outside contract manufacturers for a portion of the manufacturing process for some of our products;
- length and variability of the sales cycles of our products;
- unanticipated increases in costs or expenses;
- the loss of key employees;
- different capital expenditure and budget cycles for our customers, affecting the timing of their spending for our products;
- political stability in the areas of the world in which we operate;
- fluctuations in foreign currency exchange rates;
- changes in accounting rules;
- the evolving and unpredictable nature of the markets for products incorporating our solutions; and
- general economic conditions and changes in such conditions specific to our target markets.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly and annual operating results. In addition, a significant amount of our operating expenses is relatively fixed in nature due to our internal manufacturing, research and development, sales and general administrative efforts. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of such revenue shortfall on our results of operations. For these reasons, you should not rely on quarter-to-quarter comparisons of our results of operations as an indicator of future performance. Moreover, our operating results may not meet our announced guidance or the expectations of research analysts or investors, in which case the price of our common stock could decrease significantly. There can be no assurance that we will be able to successfully address these risks.

We depend on key personnel to develop and maintain our technology and manage our business in a rapidly changing market.

The continued services of our executive officers and other key engineering, sales, marketing, manufacturing and support personnel is essential to our success. For example, our ability to achieve new design wins depends upon the experience and expertise of our engineers. Any of our key employees, including our Chief Executive Officer, Chief Financial Officer, Chief Strategy Officer, Senior Vice President of Network Equipment Module Business Unit, Senior Vice President of Optical Module Division and Asia General Manager, may resign at any time. We do not have key person life insurance policies covering any of our employees. To implement our business plan, we also intend to hire additional employees, particularly in the areas of engineering, manufacturing and sales. Our ability to continue to attract and retain highly skilled employees is a critical factor in our success. Competition for highly skilled personnel is intense. We may not be successful in attracting, assimilating or retaining qualified personnel to satisfy our current or future needs. Our ability to develop, manufacture and sell our products, and thus our financial condition and results of operations, would be adversely affected if we are unable to retain existing personnel or hire additional qualified personnel.

We depend on a limited number of suppliers and any supply interruption could have an adverse effect on our business.

We depend on a limited number of suppliers for certain raw materials and components used in our products. Some of these suppliers could disrupt our business if they stop, decrease or delay shipments or if the materials or components they ship have quality or reliability issues. Some of the raw materials and components we use in our products are available only from a sole source or have been qualified only from a single supplier. Furthermore, other than our current suppliers, there are a limited number of entities from whom we could obtain certain materials and components. We may also face shortages if we experience increased demand for materials or components beyond what our qualified suppliers can deliver. Our inability to obtain sufficient quantities of critical materials or components could adversely affect our ability to meet demand for our products, adversely affecting our financial condition and results of operation.

We typically have not entered into long-term agreements with our suppliers and, therefore, our suppliers could stop supplying materials and components to us at any time or fail to supply adequate quantities of materials or components to us on a timely basis. It is difficult, costly, time consuming and, on short notice, sometimes impossible for us to identify and qualify new suppliers. Our customers generally restrict our ability to change the components in our products. For more critical components, any changes may require repeating the entire qualification process. Our reliance on a limited number of suppliers or a single qualified vendor may result in delivery and quality problems, and reduced control over product pricing, reliability and performance.

We depend upon outside contract manufacturers for a portion of the manufacturing process for some of our products.

Almost all of our products are manufactured internally. However we also rely upon manufacturers in China, Taiwan and other Asia locations to provide back-end manufacturing and produce the finished portion of a few of our products. Our reliance on a contract manufacturer for these products makes us vulnerable to possible capacity constraints and reduced control over delivery schedules, manufacturing yields, manufacturing quality/controls and costs. If one of our contract manufacturers is unable to meet all of our customer demand in a timely fashion, this could have a material adverse effect on the revenue from our products. If the contract manufacturer for one of our product were unable or unwilling to manufacture such produce in required volumes and at high quality levels or to continue our existing supply arrangement, we would have to identify, qualify and select an acceptable alternative contract manufacturer or move these manufacturing operations to our internal manufacturing facilities. An alternative contract manufacturer may not be available to us when needed or may not be in a position to satisfy our quality or production requirements on commercially reasonable terms, including price. Any significant interruption in manufacturing our products would require us to reduce our supply of products to our customers, which in turn, would reduce our revenue, harm our relationships with the customer of these products and cause us to forego potential revenue opportunities.

Our products could contain defects that may cause us to incur significant costs or result in a loss of customers.

Our products are complex and undergo quality testing as well as formal qualification by our customers. Our customers' testing procedures are limited to evaluating our products under likely and foreseeable failure scenarios and over varying amounts of time. For various reasons, such as the occurrence of performance problems that are unforeseeable in testing or that are detected only when products age or are operated under peak stress conditions, our products may fail to perform as expected long after customer acceptance. Failures could result from faulty components or design, problems in manufacturing or other unforeseen reasons. As a result, we could incur significant costs to repair or replace defective products under warranty, particularly when such failures occur in installed systems. Our products are typically embedded in, or deployed in conjunction with, our customers' products, which incorporate a variety of components, modules and subsystems and may be expected to interoperate with modules produced by third parties. As a result, not all defects are immediately detectable and when problems occur, it may be difficult to identify the source of the problem. While we have not experienced material failures in the past, we will continue to face this risk going forward because our products are widely deployed in many demanding environments and applications worldwide. In addition, we may in certain circumstances honor warranty claims after the warranty has expired or for problems not

covered by warranty to maintain customer relationships. Any significant product failure could result in litigation, damages, repair costs and lost future sales of the affected product and other products, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems, all of which would harm our business. Although we carry product liability insurance, this insurance may not adequately cover our costs arising from defects in our products or otherwise.

We face a variety of risks associated with our international sales and operations.

We currently derive, and expect to continue to derive, a significant portion of our revenue from sales to international customers. In 2014, 2013 and 2012, 29.5%, 41.0% and 55.7% of our revenue was derived from sales that occurred outside of North America, respectively. In addition, a significant portion of our manufacturing operations is based in Ningbo, China and Taipei, Taiwan. Our international revenue and operations are subject to a number of material risks, including:

- difficulties in staffing, managing and supporting operations in more than one country;
- difficulties in enforcing agreements and collecting receivables through foreign legal systems;
- fewer legal protections for intellectual property in foreign jurisdictions;
- foreign and U.S. taxation issues and international trade barriers;
- difficulties in obtaining any necessary governmental authorizations for the export of our products to certain foreign jurisdictions;
- fluctuations in foreign economies;
- fluctuations in the value of foreign currencies and interest rates;
- trade and travel restrictions;
- domestic and international economic or political changes, hostilities and other disruptions in regions where we currently operate or may operate in the future;
- difficulties and increased expenses in complying with a variety of U.S. and foreign laws, regulations and trade standards, including the Foreign Corrupt Practices Act; and
- different and changing legal and regulatory requirements in the jurisdictions in which we currently operate or may operate in the future.

Negative developments in any of these factors in China or Taiwan or other countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, difficulties in producing and delivering our products, threats to our intellectual property, difficulty in collecting receivables, and a higher cost of doing business. Although we maintain certain compliance programs throughout the company, violations of U.S. and foreign laws and regulations may result in criminal or civil sanctions, including material monetary fines, penalties and other costs against us or our employees, and may have a material adverse effect on our business.

Our business operations conducted in China and Taiwan are important to our success. A substantial portion of our property, plant and equipment is located in China and Taiwan. We expect to make further investments in China and Taiwan in the future. Therefore, our business, financial condition, results of operations and prospects are subject to economic, political, legal, and social events and developments in China and Taiwan. Factors affecting military, political or economic conditions in China and Taiwan could have a material adverse effect on our financial condition and results of operations, as well as the market price and the liquidity of our common shares.

In some instances, we rely on third parties to assist in selling our products, and the failure of those parties to perform as expected could reduce our future revenue.

Although we primarily sell our products through direct sales, we also sell our products to some of our customers through third party sales representatives and distributors. Many of such third parties also market and sell products from our competitors. Our third party sales representatives and distributors may terminate their relationships with us at any time, or with short notice. Our future performance will also depend, in part, on our ability to attract additional third party sales representatives and distributors that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. If our current third party sales representatives and distributors fail to perform as expected, our revenue and results of operations could be harmed.

Failure to manage our growth effectively may adversely affect our financial condition and results of operations.

Successful implementation of our business plan in our target markets requires effective planning and management. Our production volumes are increasing significantly and we have announced plans to increase our production capacity in response to demand for our products, adding both personnel as well as expanding our physical manufacturing facilities. We currently operate facilities in Sugar Land, Texas, Ningbo, China and Taipei, Taiwan. We currently manufacture our lasers using a proprietary process and customized equipment located only in our Sugar Land, Texas facility, and it will be costly to duplicate that facility, to scale our laser manufacturing capacity or to mitigate the risks associated with operating a single facility. The challenges of managing our geographically dispersed operations have increased and will continue to increase the demand on our management systems and resources. Moreover, we are continuing to improve our financial and managerial controls, reporting systems and procedures. Any failure to manage our expansion and the resulting demands on our management systems and resources effectively may adversely affect our financial condition and results of operations.

Our loan agreements contain restrictive covenants that may adversely affect our ability to conduct our business.

We have lending arrangements with several financial institutions, including loan agreements with East West Bank and Comerica Bank in the U.S., and our Taiwan branch and China subsidiary have several lines of credit arrangements. Our loan agreements governing our short- and long-term debt obligations contain certain financial and operating covenants that limit our management's discretion with respect to certain business matters. Among other things, these covenants require us to maintain certain financial ratios and restrict our ability to incur additional debt in the U.S., create liens or other encumbrances, change the nature of our business, pay dividends, make intra-company loans, sell or otherwise dispose of assets and merge or consolidate with other entities. These restrictions may limit our flexibility in responding to business opportunities, competitive developments and adverse economic or industry conditions. Any failure by us or our subsidiaries to comply with these agreements could harm our business, financial condition and operating results. In addition, our obligations under our U.S. loan agreements with East West Bank and Comerica Bank are secured by substantially all of our U.S. assets. A breach of any of covenants under our loan agreements, or a failure to pay interest or indebtedness when due under any of our credit facilities, could result in a variety of adverse consequences, including the acceleration of our indebtedness.

We may not be able to obtain additional capital when desired, on favorable terms or at all.

We operate in a market that makes our prospects difficult to evaluate and, to remain competitive, we will be required to make continued investments in capital equipment, facilities and technological improvements. We expect that substantial capital will be required to expand our manufacturing capacity and fund working capital for anticipated growth. If we do not generate sufficient cash flow from operations or otherwise have the capital resources to meet our future capital needs, we may need additional financing to implement our business strategy, which includes:

- expansion of research and development;
- expansion of manufacturing capabilities;
- hiring of additional technical, sales and other personnel; and
- acquisitions of complementary businesses.

If we raise additional funds through the issuance of our common stock or convertible securities, the ownership interests of our stockholders could be significantly diluted. These newly issued securities may have rights, preferences or privileges senior to those of existing stockholders. Additional financing may not, however, be available on terms favorable to us, or at all, if and when needed, and our ability to fund our operations, take advantage of unanticipated opportunities, develop or enhance our infrastructure or respond to competitive pressures could be significantly limited. If we cannot raise required capital when needed, we may be unable to meet the demands of existing and prospective customers, adversely affecting our sales and market opportunities and consequently our business, financial condition and results of operations.

Future acquisitions may adversely affect our financial condition and results of operations.

As part of our business strategy, we may pursue acquisitions of companies that we believe could enhance or complement our current product portfolio, augment our technology roadmap or diversify our revenue base. Acquisitions involve numerous risks, any of which could harm our business, including:

- difficulties integrating the acquired business;
- unanticipated costs, capital expenditures or liabilities or changes related to research in progress and product development;
- diversion of financial and management resources from our existing business;
- difficulties integrating the business relationships with suppliers and customers of the acquired business with our existing business relationships;
- risks associated with entering markets in which we have little or no prior experience; and
- potential loss of key employees, particularly those of the acquired organizations.

Acquisitions may also result in the recording of goodwill and other intangible assets subject to potential impairment in the future, adversely affecting our operating results. We may not achieve the anticipated benefits of an acquisition if we fail to evaluate it properly, and we may incur costs in excess of what we anticipate. A failure to evaluate and execute an acquisition appropriately or otherwise adequately address these risks may adversely affect our financial condition and results of operations.

We may be subject to disruptions or failures in information technology systems and network infrastructures that could have a material adverse effect on our business and financial condition.

We rely on the efficient and uninterrupted operation of complex information technology systems and network infrastructures to operate our business. A disruption, infiltration or failure of our information technology systems as a result of software or hardware malfunctions, system implementations or upgrades, computer viruses, third-party security breaches, employee error, theft or misuse, malfeasance, power disruptions, natural disasters or accidents could cause a breach of data security, loss of intellectual property and critical data and the release and misappropriation of sensitive competitive information and partner, customer, and employee personal data. Any of these events could harm our competitive position, result in a loss of customer confidence, cause us to incur significant costs to remedy any damages and ultimately materially adversely affect our business and financial condition.

Our future results of operations may be subject to volatility as a result of exposure to fluctuations in currency exchange rates.

We have significant foreign currency exposure, and are affected by fluctuations among the U.S. dollar, the Chinese renminbi, or RMB, and the New Taiwan dollar, or NT dollar, because a substantial portion of our business is conducted in China and Taiwan. Our sales, raw materials, components and capital expenditures are denominated in U.S. dollars, RMB and NT dollars in varying amounts.

Foreign currency fluctuations may adversely affect our revenue and our costs and expenses, and hence our results of operations. The value of the NT dollar or the RMB against the U.S. dollar and other currencies may fluctuate and be affected by, among other things, changes in political and economic conditions. The RMB currency is no longer being pegged solely to the value of the U.S. dollar. In the long term, the RMB may appreciate or depreciate significantly in value against the U.S. dollar, depending upon the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the RMB against the U.S. dollar. In addition, our currency exchange variations may be magnified by Chinese exchange control regulations that restrict our ability to convert RMB into foreign currency.

Our sales in Europe are denominated in U.S. dollars and fluctuations in the Euro or our customers' other local currencies relative to the U.S. dollar may impact our customers and affect our financial performance. If our customers' local currencies weaken against the U.S. dollar, we may need to lower our prices to remain competitive in our international markets which could have a material adverse effect on our margins. If our customers' local currencies strengthen against the U.S. dollar and if the local sales prices cannot be raised due to competitive pressures, we will experience a deterioration of our margins.

To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedging transactions may be limited and we may not be able to successfully hedge our exposure.

Natural disasters or other catastrophic events could harm our operations.

Our operations in the U.S., China and Taiwan could be subject to significant risk of natural disasters, including earthquakes, hurricanes, typhoons, flooding and tornadoes, as well as other catastrophic events, such as epidemics, terrorist attacks or wars. For example, our corporate headquarters and wafer fabrication facility in Sugar Land, Texas, is located near Gulf of Mexico, an area that is susceptible to hurricanes. We use a proprietary MBE laser manufacturing process that requires customized equipment, and this process is currently conducted and located solely at our wafer fabrication facility in Sugar Land, Texas, such that a natural disaster, terrorist attack or other catastrophic event that affects that facility would materially harm our operations. In addition, our manufacturing facility in Taipei, Taiwan, is susceptible to typhoons and disruptions in the domestic water supply, and our manufacturing facilities in Ningbo, China, and Taipei, Taiwan, have from time to time, suffered electrical outages. Any disruption in our manufacturing facilities arising from these and other natural disasters or other catastrophic events could cause significant delays in the production or shipment of our products until we are able to shift production to different facilities or arrange for third parties to manufacture our products. We may not be able to obtain alternate capacity on favorable terms or at all. Our property insurance coverage with respect to natural disaster is limited and is subject to deductible and coverage limits. Such coverage may not be adequate or continue to be available at commercially reasonable rates and terms. The occurrence of any of these circumstances may adversely affect our financial condition and results of operation.

If we fail to protect, or incur significant costs in defending, our intellectual property and other proprietary rights, our business and results of operations could be materially harmed.

Our success depends on our ability to protect our intellectual property and other proprietary rights. We rely on a combination of patent, trademark, copyright, trade secret and unfair competition laws, as well as license agreements and other contractual provisions, to establish and protect our intellectual property and other proprietary rights. We have applied for patent registrations in the U.S. and in other foreign countries, some of which have been issued. In addition, we have registered certain trademarks in the U.S. We cannot guarantee that our pending applications will be

approved by the applicable governmental authorities. Moreover, our existing and future patents and trademarks may not be sufficiently broad to protect our proprietary rights or may be held invalid or unenforceable in court. A failure to obtain patents or trademark registrations or a successful challenge to our registrations in the U.S. or other foreign countries may limit our ability to protect the intellectual property rights that these applications and registrations intended to cover.

Policing unauthorized use of our technology is difficult and we cannot be certain that the steps we have taken will prevent the misappropriation, unauthorized use or other infringement of our intellectual property rights. Further, we may not be able to effectively protect our intellectual property rights from misappropriation or other infringement in foreign countries where we have not applied for patent protections, and where effective patent, trademark, trade secret and other intellectual property laws may be unavailable, or may not protect our proprietary rights as fully as U.S. law. We may seek to secure comparable intellectual property protections in other countries. However, the level of protection afforded by patent and other laws in other countries may not be comparable to that afforded in the U.S.

We also attempt to protect our intellectual property, including our trade secrets and know-how, through the use of trade secret and other intellectual property laws, and contractual provisions. We enter into confidentiality and invention assignment agreements with our employees and independent consultants. We also use non-disclosure agreements with other third parties who may have access to our proprietary technologies and information. Such measures, however, provide only limited protection, and there can be no assurance that our confidentiality and non-disclosure agreements will not be breached, especially after our employees end their employment, and that our trade secrets will not otherwise become known by competitors or that we will have adequate remedies in the event of unauthorized use or disclosure of proprietary information. Unauthorized third parties may try to copy or reverse engineer our products or portions of our products, otherwise obtain and use our intellectual property, or may independently develop similar or equivalent trade secrets or know-how. If we fail to protect our intellectual property and other proprietary rights, or if such intellectual property and proprietary rights are infringed or misappropriated, our business, results of operations or financial condition could be materially harmed.

In the future, we may need to take legal actions to prevent third parties from infringing upon or misappropriating our intellectual property or from otherwise gaining access to our technology. Protecting and enforcing our intellectual property rights and determining their validity and scope could result in significant litigation costs and require significant time and attention from our technical and management personnel, which could significantly harm our business. We may not prevail in such proceedings, and an adverse outcome may adversely impact our competitive advantage or otherwise harm our financial condition and our business.

We may be involved in intellectual property disputes in the future, which could divert management's attention, cause us to incur significant costs and prevent us from selling or using the challenged technology.

Participants in the markets in which we sell our products have experienced frequent litigation regarding patent and other intellectual property rights. While we have a policy in place that is designed to reduce the risk of infringement of intellectual property rights of others and we have conducted a limited review of other companies' relevant patents, there can be no assurance that third parties will not assert infringement claims against us. We cannot be certain that our products would not be found infringing on the intellectual property rights of others. Regardless of their merit, responding to such claims can be time consuming, divert management's attention and resources and may cause us to incur significant expenses. Intellectual property claims against us could force us to do one or more of the following:

- obtain from a third party claiming infringement a license to the relevant technology, which may not be available on reasonable terms, or at all;
- stop manufacturing, selling, incorporating or using our products that use the challenged intellectual property;
- pay substantial monetary damages; or
- expend significant resources to redesign the products that use the technology and to develop non-infringing technology.

Any of these actions could result in a substantial reduction in our revenue and could result in losses over an extended period of time.

In any potential intellectual property dispute, our customers could also become the target of litigation. Because we often indemnify our customers for intellectual property claims made against them with respect to our products, any claims against our customers could trigger indemnification claims against us. These obligations could result in substantial expenses such as legal expenses, damages for past infringement or royalties for future use. Any indemnity claim could also adversely affect our relationships with our customers and result in substantial costs to us.

If we fail to obtain the right to use the intellectual property rights of others that are necessary to operate our business, and to protect their intellectual property, our business and results of operations will be adversely affected.

From time to time we may choose to or be required to license technology or intellectual property from third parties in connection with the development of our products. We cannot assure you that third party licenses will be available to us on commercially reasonable terms, if at all. Generally, a license, if granted, would include payments of up-front fees, ongoing royalties or both. These payments or other terms could have a significant adverse impact on our results of operations. Our inability to obtain a necessary third party license required for our product offerings or to develop new products and product enhancements could require us to substitute technology of lower quality or performance standards, or of greater cost, either of which could adversely affect our business. If we are not able to obtain licenses from third parties, if necessary, then we may also be subject to litigation to defend against infringement claims from these third parties. Our competitors may be able to obtain licenses or cross-license their technology on better terms than we can, which could put us at a competitive disadvantage.

If we fail to maintain effective internal control over financial reporting in the future, the accuracy and timing of our financial reporting may be adversely affected.

Preparing our consolidated financial statements involves a number of complex manual and automated processes, which are dependent upon individual data input or review and require significant management judgment. One or more of these elements may result in errors that may not be detected and could result in a material misstatement of our consolidated financial statements. We have not performed an evaluation of our internal control over financial reporting, such as would be required by Section 404 of the Sarbanes-Oxley Act, nor have we engaged our independent registered public accounting firm to perform an audit of our internal control over financial reporting. In addition, for so long as we qualify as an “emerging growth company” under the JOBS Act, which may be up to five years following our initial public offering in September 2013, we will not have to provide an auditor’s attestation report on our internal controls in future annual reports on Form 10-K as otherwise required by Section 404(b) of the Sarbanes-Oxley Act. During the course of any evaluation, documentation or attestation, we or our independent registered public accounting firm may identify weaknesses and deficiencies that we may not otherwise identify in a timely manner or at all as a result of the deferred implementation of this additional level of review.

We have implemented internal controls that we believe provide reasonable assurance that we will be able to avoid accounting errors or material weaknesses in future periods. However, our internal controls cannot guarantee that no accounting errors exist or that all accounting errors, no matter how immaterial, will be detected because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute assurance that the control system's objectives will be met. If we are unable to implement and maintain effective internal control over financial reporting, our ability to accurately and timely report our financial results could be adversely impacted. This could result in late filings of our annual and quarterly reports under the Securities Exchange Act of 1934, or the Exchange Act, restatements of our consolidated financial statements, a decline in our stock price, suspension or delisting of our common stock by NASDAQ, or other material adverse effects on our business, reputation, results of operations or financial condition.

Our ability to use our net operating losses and certain other tax attributes may be limited.

As of December 31, 2014, we had U.S. accumulated net operating losses, or NOLs, of approximately \$56.5 million for U.S. federal income tax purposes. Under Section 382 of the Internal Revenue Code of 1986, as amended, if a corporation undergoes an "ownership change," the corporation's ability to use its pre-change NOLs, R&D credits and other pre-change tax attributes to offset its post-change income may be limited. An ownership change is generally defined as a greater than 50% change in equity ownership by value over a 3-year period. Based upon an analysis of our equity ownership, we have experienced an ownership change and our NOL is limited in dollar amount. As of December 31, 2014, of the total accumulated NOL, only \$31.5 million is available for utilization in future periods to offset federal taxable income. Each year after 2014, an additional \$0.3 million is added to the total available NOL, until a maximum of \$34.9 million is reached. The amount of NOL available each year may decrease by the amount of NOL utilized and may increase by the amount of any operating losses incurred. Should we experience additional ownership changes, our NOL carry forwards may be further limited.

Changes in our effective tax rate may adversely affect our results of operation and our business.

We are subject to income taxes in the U.S. and other foreign jurisdictions, including Taiwan and China. We base our tax position on the anticipated nature and conduct of our business and our understanding of the tax laws of the countries in which we have assets or conduct activities. Our tax position may be reviewed or challenged by tax authorities. Moreover, the tax laws currently in effect may change, and such changes may have retroactive effect. We have inter-company arrangements in place providing for administrative and financing services and transfer pricing, which involve a significant degree of judgment and are often subject to close review by tax authorities. The tax authorities may challenge our positions related to these agreements. If the tax authorities successfully challenge our positions, our effective tax rate may increase, adversely affecting our results of operation and our business.

Our manufacturing operations are subject to environmental regulation that could limit our growth or impose substantial costs, adversely affecting our financial condition and results of operations.

Our properties, operations and products are subject to the environmental laws and regulations of the jurisdictions in which we operate and sell products. These laws and regulations govern, among other things, air emissions, wastewater discharges, the management and disposal of hazardous materials, the contamination of soil and groundwater, employee health and safety and the content, performance, packaging and disposal of products. Our failure to comply with current and future environmental laws and regulations, or the identification of contamination for which we are liable, could subject us to substantial costs, including fines, clean-up costs, third-party property damages or personal injury claims, and make significant investments to upgrade our facilities or curtail our operations. Liability under environmental, health and safety laws can be joint and several and without regard to fault or negligence. For example, pursuant to environmental laws and regulations, including but not limited to the Comprehensive Environmental Response Compensation and Liability Act, or CERCLA, we may be liable for the full amount of any remediation-related costs at properties we currently own or formerly owned, such as our currently owned Sugar Land, Texas facility, or at properties at which we operated, as well as at properties we will own or operate in the future, and properties to which we have sent hazardous substances, whether or not we caused the contamination. Identification of presently unidentified environmental conditions, more vigorous enforcement by a governmental authority, enactment of more stringent legal requirements or other unanticipated events could give rise to adverse publicity, restrict our operations, affect the design or marketability of our products or otherwise cause us to incur material environmental costs, adversely affecting our financial condition and results of operations.

We are exposed to risks and increased expenses and business risk as a result of Restriction on Hazardous Substances, or RoHS directives.

Following the lead of the European Union, or EU, various governmental agencies have either already put into place or are planning to introduce regulations that regulate the permissible levels of hazardous substances in products sold in various regions of the world. For example, the RoHS directive for EU took effect on July 1, 2006. The labeling provisions of similar legislation in China went into effect on March 1, 2007. Consequently, many suppliers of products sold into the EU have required their suppliers to be compliant with the new directive. Many of our customers have adopted this approach and have required our full compliance. Though we have devoted a significant amount of resources and effort in planning and executing our RoHS program, it is possible that some of our products might be incompatible with such regulations. In such events, we could experience the following consequences: loss of revenue, damages reputation, diversion of resources, monetary penalties, and legal action.

Failure to comply with the U.S. Foreign Corrupt Practices Act could subject us to penalties and other adverse consequences.

We are subject to the U.S. Foreign Corrupt Practices Act which generally prohibits U.S. companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. In addition, we are required to maintain records that accurately and fairly represent our transactions and have an adequate system of internal accounting controls. Foreign companies, including some that may compete with us, may not be subject to these prohibitions, and therefore may have a competitive advantage over us. If we are not successful in implementing and maintaining adequate preventative measures, we may be responsible for acts of our employees or other agents engaging in such conduct. We could suffer severe penalties and other consequences that may have a material adverse effect on our financial condition and results of operations.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

We are subject to export and import control laws, trade regulations and other trade requirements that limit which products we sell and where and to whom we sell our products. Specifically, the Bureau of Industry and Security of the U.S. Department of Commerce is responsible for regulating the export of most commercial items that are so called dual-use goods that may have both commercial and military applications. A limited number of our products are exported by license under the Export Control Classification Number, or ECCN, of 5A991. Export Control Classification requirements are dependent upon an item's technical characteristics, the destination, the end-use, and the end-user, and other activities of the end-user. Should the regulations applicable to our products change, or the restrictions applicable to countries to which we ship our products change, then the export of our products to such countries could be restricted. As a result, our ability to export or sell our products to certain countries could be restricted, which could adversely affect our business, financial condition and results of operations. Changes in our products or any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could result in delayed or decreased sales of our products to existing or potential customers. In such event, our business and results of operations could be adversely affected.

Rapidly changing standards and regulations could make our products obsolete, which would cause our revenue and results of operations to suffer.

We design our products to conform to regulations established by governments and to standards set by industry standards bodies worldwide, such as the American National Standards Institute, the European Telecommunications Standards Institute, the International Telecommunications Union and the Institute of Electrical and Electronics Engineers, Inc. Various industry organizations are currently considering whether and to what extent to create standards applicable to our products. Because certain of our products are designed to conform to current specific

industry standards, if competing or new standards emerge that are preferred by our customers, we would have to make significant expenditures to develop new products. If our customers adopt new or competing industry standards with which our products are not compatible, or the industry groups adopt standards or governments issue regulations with which our products are not compatible, our existing products would become less desirable to our customers and our revenue and results of operations would suffer.

Compliance with regulations related to conflict minerals could increase costs and affect the manufacturing and sale of our products.

Public companies are required to disclose the use of tin, tantalum, tungsten and gold (collectively, “conflict minerals”) mined from the Democratic Republic of the Congo and adjoining countries (the “covered countries”) if a conflict mineral(s) is necessary to the functionality of a product manufactured, or contracted to be manufactured, by the company. We may determine, as part of our compliance efforts, that certain products or components we obtain from our suppliers contain conflict minerals. If we are unable to conclude that all our products are free from conflict minerals originating from covered countries, this could have a negative impact on our business, reputation and/or results of operations. We may also encounter challenges to satisfy customers who require that our products be certified as conflict free, which could place us at a competitive disadvantage if we are unable to substantiate such a claim. Compliance with these rules could also affect the sourcing and availability of some of the minerals used in the manufacture of products or components we obtain from our suppliers, including our ability to obtain products or components in sufficient quantities and/or at competitive prices. Certain of our customers are requiring additional information from us regarding the origin of our raw materials, and complying with these customer requirements may cause us to incur additional costs, such as costs related to determining the origin of any minerals used in our products. Our supply chain is complex and we may be unable to verify the origins for all metals used in our products. We may also encounter challenges with our customers and stockholders if we are unable to certify that our products are conflict free.

Risks Related to Our Operations in China

Adverse changes in economic and political policies in China, or Chinese laws or regulations could have a material adverse effect on business conditions and the overall economic growth of China, which could adversely affect our business.

The Chinese economy differs from the economies of most developed countries in many respects, including the level of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. Despite reforms, the government continues to exercise significant control over China's economic growth by way of the allocation of resources, control over foreign currency-denominated obligations and monetary policy and provision of preferential treatment to particular industries or companies.

In addition, the laws, regulations and legal requirements in China, including the laws that apply to foreign-invested enterprises, or FIEs, are subject to frequent changes. The interpretation and enforcement of such laws is uncertain. Protections of intellectual property rights and confidentiality in China may not be as effective as in the U.S. or other countries or regions with more developed legal systems. Any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. Any adverse changes to these laws, regulations and legal requirements or their interpretation or enforcement could have a material adverse effect on our business.

Furthermore, while China's economy has experienced rapid growth in the past 20 years, growth has been uneven across different regions, among various economic sectors and over time. China has also in the past and may in the future experience economic downturns due to, for example, government austerity measures, changes in government policies relating to capital spending, limitations placed on the ability of commercial banks to make loans, reduced levels of exports and international trade, inflation, lack of financial liquidity, stock market volatility and global economic conditions. Any of these developments could contribute to a decline in business and consumer spending in addition to other adverse market conditions, which could adversely affect our business.

The termination and expiration or unavailability of our preferential tax treatments in China may have a material adverse effect on our operating results.

Prior to January 1, 2008, entities established in China were generally subject to a 30% state and 3% local enterprise income tax rate. In accordance with the China Income Tax Law for Enterprises with Foreign Investment and Foreign Enterprises, effective through December 31, 2007, our China subsidiary enjoyed preferential income tax rates. Effective January 1, 2008, the China Enterprise Income Tax Law, or the EIT law, imposes a single uniform income tax rate of 25% on all Chinese enterprises, including FIEs, and eliminates or modifies most of the tax exemptions,

reductions and preferential treatment available under the previous tax laws and regulations. As a result, our China subsidiary may be subject to the uniform income tax rate of 25% unless we are able to qualify for preferential status. Currently, we have qualified for a preferential 15% tax rate that is available for state-encouraged new high technology enterprises. The preferential rate has applied to calendar years 2012 through 2014, and we have received approval from the Chinese government to extend this preferential rate for 2015 through 2017. Any future increase in the enterprise income tax rate applicable to us or the expiration or other limitation of preferential tax rates available to us could increase our tax liabilities and reduce our net income.

China regulation of loans and direct investment by offshore holding companies to China entities may delay or prevent us from making loans or additional capital contributions to our China subsidiary.

Any loans that we wish to make to our China subsidiary are subject to China regulations and approvals. For example, any loans to our China subsidiary to finance their activities cannot exceed statutory limits, must be registered with State Administration of Foreign Exchange, or SAFE, or its local counterpart, and must be approved by the relevant government authorities. Any capital contributions to our China subsidiary must be approved by the Ministry of Commerce or its local counterpart. In addition, under Circular 142, our China subsidiary, as a FIE, may not be able to convert our capital contributions to them into RMB for equity investments or acquisitions in China.

We cannot assure you that we will be able to obtain these government registrations or approvals on a timely basis, if at all, with respect to our future loans or capital contributions to our China subsidiary. If we fail to receive such registrations or approvals, our ability to capitalize our China subsidiary may be negatively affected, which could materially and adversely affect our liquidity and ability to fund and expand our business.

Our China subsidiary is subject to Chinese labor laws and regulations and Chinese labor laws may increase our operating costs in China.

The China Labor Contract Law, together with its implementing rules, provides increased rights to Chinese employees. Previously, an employer had discretionary power in deciding the probation period, not to exceed six months. Additionally, the employment contract could only be terminated for cause. Under these rules, the probation period varies depending on contract terms and the employment contract can only be terminated during the probation period for cause upon three days' notice. Additionally, an employer may not be able to terminate a contract during the probation period on the grounds of a material change of circumstances or a mass layoff. The new law also has specific provisions on conditions when an employer has to sign an employment contract with open-ended terms. If an employer fails to enter into an open-ended contract in certain circumstances, the employer must pay the employee twice their monthly wage beginning from the time the employer should have executed an open-ended contract. Additionally an employer must pay severance for nearly all terminations, including when an employer decides not to renew a fixed-term contract. These laws may increase our costs and reduce our flexibility.

The turnover of direct labor in manufacturing industries in China is high, which could adversely affect our production, shipments and results of operations.

Employee turnover of direct labor in the manufacturing sector in China is high and retention of such personnel is a challenge to companies located in or with operations in China. Although direct labor costs do not represent a high proportion of our overall manufacturing costs, direct labor is required for the manufacture of our products. If our direct labor turnover rates are higher than we expect, or we otherwise fail to adequately manage our direct labor turnover rates, then our results of operations could be adversely affected.

An increase in our labor costs in China may adversely affect our business and our profitability.

A significant portion of our workforce is located in China. Labor costs in China have been increasing recently due to labor unrest, strikes and changes in employment laws. If labor costs in China continue to increase, our costs will increase. If we are not able to pass these increases on to our customers, our business, profitability and results of operations may be adversely affected.

We may have difficulty establishing and maintaining adequate management and financial controls over our China operations.

Businesses in China have historically not adopted a western style of management and financial reporting concepts and practices, which includes strong corporate governance, internal controls and computer, financial and other control systems. Moreover, familiarity with U.S. GAAP principles and reporting procedures is less common in China. As a consequence, we may have difficulty finding accounting personnel experienced with U.S. GAAP, and we may have difficulty training and integrating our China-based accounting staff with our U.S.-based finance organization. As a result of these factors, we may experience difficulty in establishing management and financial controls over our China operations. These difficulties include collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet U.S. public-company reporting requirements. We may, in turn, experience difficulties in implementing and maintaining adequate internal controls as required under Section 404 of the Sarbanes-Oxley Act.

Risks Related to Our Common Stock

Our stock price has been and is likely to be volatile.

The market price of our common stock has been and is likely to be subject to wide fluctuations in response to, among other things, the risk factors described in this section of this Quarterly Report on Form 10-Q, and other factors beyond our control, such as fluctuations in the valuation of companies perceived by investors to be comparable to us.

Furthermore, the stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions, such as recessions, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock.

In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may become the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

We have incurred and will continue to incur significant increased expenses and administrative burdens as a public company, which could have a material adverse effect on our operations and financial results.

We face increased legal, accounting, administrative and other costs and expenses as a public company that we did not incur as a private company, and greater expenditures may be necessary in the future with the advent of new laws, regulations and stock exchange listing requirements pertaining to public companies. These increased costs will require us to divert a significant amount of money that we could otherwise use to expand our business and achieve our strategic objectives. The Sarbanes-Oxley Act, including the requirements of Section 404, as well as rules and regulations subsequently implemented by the SEC, the Public Company Accounting Oversight Board and the NASDAQ Global Market, impose additional reporting and other obligations on public companies. Compliance with public company requirements has increased our costs and made some activities more time-consuming. For example, we have created new board committees and adopted new internal controls and disclosure controls and procedures. In addition, we will have incurred and will continue to incur additional expenses associated with our SEC reporting requirements. Furthermore, if we identify any issues in complying with those requirements (for example, if we or our auditors identify a material weakness or significant deficiency in our internal control over financial reporting), we could incur additional costs rectifying those issues, and the existence of those issues could adversely affect us, our reputation or investor perceptions of us. Advocacy efforts by stockholders and third parties may also prompt additional changes in governance and reporting requirements, which could further increase our costs.

We currently do not intend to pay dividends on our common stock and, consequently, your only opportunity to achieve a return on your investment is if the price of our common stock appreciates.

We currently do not plan to declare or pay dividends on shares of our common stock in the foreseeable future. In addition, the terms of our loan and security agreement with East West Bank restrict our ability to pay dividends. Consequently, your only opportunity to achieve a return on any shares of our common stock that you may acquire will be if the market price of our common stock appreciates and you sell your shares at a profit. There is no guarantee that the price of our common stock in the market will ever exceed the price that you pay.

Our charter documents, stock incentive plans and Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our amended and restated certificate of incorporation and our amended and restated bylaws and our stock incentive plans contain provisions that could delay or prevent a change in control of our company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include:

- providing for a classified board of directors with staggered, three-year terms;

- not providing for cumulative voting in the election of directors;
- authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock;
- prohibiting stockholder action by written consent;
- limiting the persons who may call special meetings of stockholders;
- requiring advance notification of stockholder nominations and proposals; and
- change of control provisions in our stock incentive plans, and the individual stock option agreements, which provide that a change of control may accelerate the vesting of the stock options issued under such plans.

In addition, the provisions of Section 203 of the Delaware General Corporate Law governs us. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding common stock, from engaging in certain business combinations without the approval of substantially all of our stockholders for a certain period of time.

These and other provisions in our amended and restated certificate of incorporation, our amended and restated bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay for shares of our common stock in the future and result in the market price being lower than it would be without these provisions. See “Description of Capital Stock—Preferred stock” and “Description of Capital Stock—Anti-takeover effects of Delaware law.”

Some provisions of our named executive officers’ agreements regarding change of control or separation of service contain obligations for us to make separation payments to them upon their termination.

Certain provisions contained in our employment agreements with our named executive officers regarding change of control or separation of service may obligate us to make lump sum severance payments and related payments upon the termination of their employment with us, other than such executive officer’s resignation without good reason or our termination of their employment as a result of their disability or for cause. In the event we are required to make these separation payments, it could have a material adverse effect on our results of operations for the fiscal period in which such payments are made.

If research analysts do not publish research about our business or if they issue unfavorable commentary or downgrade our common stock, our stock price and trading volume could decline.

The trading market for our common stock will depend on the research and reports that research analysts publish about us and our business. The price of our common stock could decline if one or more research analysts downgrade our common stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business. If one or more of the research analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price or trading volume to decline.

As an “emerging growth company” within the meaning of the Securities Act, we will utilize certain modified disclosure requirements, and we cannot be certain if these reduced requirements will make our common stock less attractive to investors.

We are an emerging growth company within the meaning of the rules under the Securities Act. We have in this Quarterly Report on Form 10-Q utilized, and we plan in future filings with the SEC to continue to utilize, the modified disclosure requirements available to emerging growth companies, including reduced disclosure about our executive compensation and omission of compensation discussion and analysis, and an exemption from the requirement of holding a nonbinding advisory vote on executive compensation and an exemption from the requirement that outside auditors attest as to our internal control over financial reporting. As a result, our stockholders may not have access to certain information they may deem important.

In addition, Section 107 of the JOBS Act also provides that an emerging growth company can utilize the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. Thus, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to utilize this extended transition period. Our financial statements may therefore not be comparable to those of companies that comply with such new or revised accounting standards as they become applicable to public companies.

We cannot predict if investors will find our common stock less attractive because we will rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile. We could remain an “emerging growth company” for up to five years, or until the earliest of (i) the last day of the first fiscal year in which our annual gross revenue exceed \$1 billion, (ii) the date that we become a “large accelerated filer” as defined in Rule 12b-2 under the Exchange Act, which would occur if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last business day of our most recently completed second fiscal quarter or (iii) the date on which we have issued more than \$1 billion in non-convertible debt during the preceding three-year period.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

See Exhibit Index on page 45.

SIGNATURES

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

**APPLIED
OPTOELECTRONICS, INC.**

/s/ Stefan J. Murry

Stefan J. Murry

Date: August 7, 2015 By: Chief Financial Officer
*(principal financial officer and
principal accounting officer)*

EXHIBIT INDEX

Number **Description**

- | | |
|-------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1* | Amended and Restated Certificate of Incorporation, as currently in effect (filed as Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 14, 2013). |
| 3.2* | Amended and Restated Bylaws, as currently in effect (filed as Exhibit 3.2 to the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 14, 2013). |
| 10.1* | Translation of Comprehensive Credit Line Contract and General Agreement, dated April 1, 2015, between Applied Optoelectronics, Inc., Taiwan Branch, and China Construction Bank, Taipei Branch (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 7, 2015). |
| 10.2* | Translation of Approval Notice of China Construction Bank, Taipei Branch (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 7, 2015). |
| 10.3* | Translation of Purchase and Sale Contract between Applied Optoelectronics, Inc., Taiwan Branch, and Chailease Finance Co., Ltd. (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 2, 2015). |
| 10.4* | Translation of Finance Lease Agreement between Applied Optoelectronics, Inc., Taiwan Branch, and Chailease Finance Co., Ltd. (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 2, 2015). |
| 10.5* | Fourth Amendment to Office Lease Agreement between Applied Optoelectronics, Inc. and 12808 Airport, LLC dated June 17, 2015 (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 23, 2015). |
| 10.6* | Credit Agreement, dated June 30, 2015, between Applied Optoelectronics, Inc., East West Bank and Comerica Bank (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015). |
| 10.7* | Security Agreement, dated June 30, 2015, between Applied Optoelectronics, Inc., East West Bank and Comerica Bank (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015). |
| 10.8* | Patent Security Agreement, dated June 30, 2015, between Applied Optoelectronics, Inc., East West Bank and Comerica Bank (filed as Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015). |
| 10.9* | Trademark Security Agreement, dated June 30, 2015, between Applied Optoelectronics, Inc., East West Bank and Comerica Bank (filed as Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015). |

- 10.10* East West Bank Promissory Note, dated June 30, 2015, between Applied Optoelectronics, Inc. and East West Bank (filed as Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015).
- 10.11* Comerica Bank Promissory Note, dated June 30, 2015, between Applied Optoelectronics, Inc. and Comerica Bank (filed as Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015).
- 10.12* 2nd Lien Construction Deed of Trust, dated June 30, 2015, between Applied Optoelectronics, Inc., East West Bank and Comerica Bank Lenders (filed as Exhibit 10.7 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015).
- 10.13* Translation of Purchase and Sale Contract between Applied Optoelectronics, Inc., Taiwan Branch, and Chailease Finance Co. Ltd. (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015).

- 10.14* Translation of Finance Lease Agreement and Promissory Note between Applied Optoelectronics, Inc., Taiwan Branch, and Chailease Finance Co., Ltd. (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 7, 2015).
- 31.1** Certification of Chief Executive Officer pursuant to Exchange Act Rule, 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2** Certification of Chief Financial Officer pursuant to Exchange Act Rule, 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1** Certification pursuant to 18 U.S.C. 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer and Chief Financial Officer
- 101.INS*** XBRL Instance Document.
- 101.SCH*** XBRL Taxonomy Extension Schema Document.
- 101.CAL*** XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF*** XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB*** XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE*** XBRL Taxonomy Extension Presentation Linkbase Document.

* Incorporated herein by reference to the indicated filing.

** Filed herewith.

*** XBRL (Extensible Business Reporting Language) information is furnished and not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Exchange Act of 1933, as amended, is deemed not filed for purpose of Section 18 of the Securities Exchange Act of 1934, as amended, and is not otherwise subject to liability under these Sections.