ART TECHNOLOGY GROUP INC
Form DEF 14A
April 18, 2005

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SCHEDULE 14A
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a)
of the Securities Exchange Act of 1934

Filed by the Registrant þ

Filed by a Party other than the Registrant o

Check the appropriate box:

o	Preliminary Proxy Statement	o	Confidential, for Use of the Commission only (as permitted by Rule 14a-6(e)(2))
þ	Definitive Proxy Statement		
o	Definitive Additional Materials		
o	Soliciting Material Pursuant to Rule 14a-ll(c) or Rule 14a-12		

ART TECHNOLOGY GROUP, INC.
(Name of Registrant as Specified in Its Charter)

Not Applicable
(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(l) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:

(2) Form, Schedule or Registration Statement no.:

(3) Filing Party:

(4) Date Filed:

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ART TECHNOLOGY GROUP, INC.
25 FIRST STREET
CAMBRIDGE, MASSACHUSETTS 02141

Dear Stockholder:

I am pleased to invite you to attend the 2005 Annual Meeting of Stockholders of Art Technology Group, Inc. on May 25, 2005. We will hold the meeting at 2:00 p.m. at the offices of Foley Hoag LLP, 155 Seaport Boulevard, Boston, Massachusetts. Annual meetings play an important role in maintaining communications and understanding among our management, board of directors and stockholders, and I hope that you will be able to join us.

On the pages following this letter you will find the Notice of Annual Meeting of Stockholders, which lists the matters to be considered at the meeting, and the proxy statement, which describes the matters listed in the Notice. We have also enclosed our 2004 Annual Report to Stockholders.

If you were a stockholder of record as of the close of business on April 4, 2005, the record date for voting at the meeting, we have enclosed your proxy card, which allows you to vote on the matters considered at the meeting. Simply mark, sign and date your proxy card, and then mail the completed proxy card to our transfer agent, EquiServe Trust Company, N.A., in the enclosed postage-paid envelope. You may also submit your proxy electronically via the Internet or by telephone as described on the enclosed proxy card. You may attend the meeting and vote in person even if you have sent in a proxy card or submitted your proxy electronically.

If your shares are held in the name of a bank, broker or other holder of record, you will receive instructions from the holder of record that you must follow in order for your shares to be voted.

Sincerely yours,

Robert D. Burke
Chief Executive Officer and President

THE ABILITY TO HAVE YOUR VOTE COUNTED AT THE MEETING IS AN IMPORTANT STOCKHOLDER RIGHT, AND I HOPE YOU WILL CAST YOUR VOTE IN PERSON OR BY PROXY REGARDLESS OF THE NUMBER OF SHARES YOU HOLD.

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ART TECHNOLOGY GROUP, INC.
25 First Street
Cambridge, Massachusetts 02141
Notice of 2004 Annual Meeting of Stockholders

Time and Date	2:00 p.m., Eastern time, on May 25, 2005
Place	Foley Hoag LLP 155 Seaport Boulevard Boston, Massachusetts
Items of Business	At the meeting, we will ask you and our other stockholders to: (1) Elect Michael A. Brochu, Robert D. Burke and Mary E. Makela Class III directors of the Company to serve until the 2008 Annual Meeting or until their successors are elected and qualified. (2) Transact any other business properly presented at the meeting.
Record Date	You may vote if you were a stockholder of record at the close of business on April 4, 2005.
Proxy Voting	It is important that your shares be represented and voted at the meeting. Whether or not you plan to attend the meeting, please mark, sign, date and promptly mail your proxy card to our transfer agent, EquiServe Trust Company, N.A., in the enclosed postage-paid envelope. Alternatively, you may submit your proxy via the Internet or by telephone by following the directions on the enclosed proxy card. You may revoke your proxy at any time prior to its exercise at the meeting. You may revoke electronic votes by using the same method as your original vote and making any changes you deem necessary.

By Order of the Board of Directors

Paul G. Shorthose
Chairman of the Board of Directors

Cambridge, Massachusetts
April 18, 2005

PROXY STATEMENT
for the
ART TECHNOLOGY GROUP, INC.
2005 ANNUAL MEETING OF STOCKHOLDERS
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INFORMATION ABOUT THE MEETING

This Proxy Statement

We have sent you this proxy statement and the enclosed proxy card because our board of directors is soliciting your proxy to vote at our 2005 Annual Meeting of Stockholders or any adjournment or postponement of the meeting. The meeting will be held at 2:00 p.m., Eastern time, on Wednesday, May 25, 2005, at the offices of Foley Hoag LLP, 155 Seaport Boulevard, Boston, Massachusetts.

THIS PROXY STATEMENT summarizes information about the proposals to be considered at the meeting and other information you may find useful in determining how to vote.

THE PROXY CARD is the means by which you actually authorize another person to vote your shares in accordance with the instructions.

Our directors, officers and employees may solicit proxies in person or by telephone, mail, electronic mail, facsimile or telegram. We will pay the expenses of soliciting proxies, although we will not pay additional compensation to these individuals for soliciting proxies. We will request banks, brokers and other nominees holding shares for a beneficial owner to forward copies of the proxy materials to those beneficial owners and to request instructions for voting those shares. We will reimburse these banks, brokers and other nominees for their related reasonable expenses. We have not retained the services of any proxy solicitation firm to assist us in soliciting proxies.

We are mailing this proxy statement and the enclosed proxy card to stockholders for the first time on or about April 21, 2005. In this mailing, we are enclosing a copy of our 2004 Annual Report to Stockholders, which includes our annual report on Form 10-K for the year ended December 31, 2004.

Who May Vote

Holders of record of our common stock at the close of business on April 4, 2005 are entitled to one vote per share on each matter properly brought before the meeting. The proxy card states the number of shares you are entitled to vote.

A list of stockholders entitled to vote will be available at the meeting. In addition, you may contact our Secretary at our address as set forth in the notice appearing before this proxy statement, to make arrangements to review a copy of the stockholder list at our offices located at 25 First Street, Cambridge, Massachusetts, prior to the meeting, between the hours of 8:30 a.m. and 5:30 p.m., Eastern time, on any business day from May 11, 2005 up to the time of the meeting.

How to Vote

You may vote your shares at the meeting in person or by proxy:

To Vote in Person, you must attend the meeting, and then complete and submit the ballot provided at the meeting.

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To Vote by Proxy, you must either: (1) mark, sign and date the enclosed proxy card and then mail the proxy card to our transfer agent, EquiServe Trust Company, N.A., or (2) submit your proxy card electronically via the Internet or by telephone, following the directions provided on the enclosed proxy card. Your proxy will be valid only if you complete and return the proxy card or vote electronically before the meeting. By completing and returning the proxy card, either by mail or electronically, you will direct the designated persons to vote your shares at the meeting in the manner you specify in the proxy card. If you complete the proxy card with the exception of the voting instructions, then the designated persons will vote your shares for the election of the nominated directors. If any other business properly comes before the meeting, the designated persons will have the discretion to vote your shares as they deem appropriate.

Even if you complete and return a proxy card or submit your proxy electronically, you may revoke it at any time before it is exercised by taking one of the following actions:

- send written notice to our Secretary at our address as set forth in the Notice appearing before this proxy statement;
- send us another signed proxy with a later date;
- log on to the Internet the same way you did originally and change your votes;
- call the telephone number listed on the proxy card; or
- attend the meeting, notify our Secretary that you are present, and then vote by ballot.

If your shares are held in the name of a bank, broker or other nominee holder, you will receive instructions from the holder of record explaining how your shares may be voted. Please note that, in such an event, you must obtain a proxy, executed in your favor, from the holder of record to be able to vote at the meeting.

Quorum Required to Transact Business

At the close of business on April 4, 2005, 109,193,320 shares of our common stock were outstanding. Our by-laws require that a majority of the shares of our common stock outstanding on that date be represented, in person or by proxy, at the meeting in order to constitute the quorum we need to transact business. We will count abstentions and broker non-votes in determining whether a quorum exists. A broker non-vote occurs when a nominee holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power for that particular item and has not received instructions from the beneficial owner.

DISCUSSION OF PROPOSALS

Proposal One: Election of Three Class III Directors

The first proposal on the agenda for the meeting is the election of Michael A. Brochu, Robert D. Burke and Mary E. Makela to serve as Class III directors for a three-year term beginning at the meeting and ending at our 2008 Annual Meeting of Stockholders or until their successors are elected and qualified.

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Under our by-laws, our board of directors has the authority to fix the number of directors and our board is divided into three classes serving for staggered three-year terms. The number of directors currently is fixed at nine. However, we are currently conducting a search for a tenth director to be added to our board.

The Nominating and Governance Committee has recommended that the board nominate, and the board has nominated, Michael A. Brochu, Robert D. Burke and Mary E. Makela, the current Class III directors, for re-election. Brief biographies of Mr. Brochu, Mr. Burke and Ms. Makela follow. You will find information about their stock holdings on page 21.

Michael A. Brochu	Mr. Brochu has served as a director since November 2004, when he was added to our board in connection with our acquisition of Primus Knowledge Solutions, Inc. Mr. Brochu has been the president and chief executive officer of Loudeye Corp. since February 2005, and has served as a director of Loudeye Corp. since December 2003. From November 1997 until our acquisition of Primus in November 2004, Mr. Brochu served as the President, Chief Executive Officer and Chairman of the Board of Primus. Mr. Brochu is 51 years old.
Robert D. Burke	Mr. Burke has served as our Chief Executive Officer and President and as a director since December 2002. From November 2000 through November 2002, Mr. Burke served as Chief Executive Officer of Quidnunc, a customer solutions and services company. From June 1999 through October 2000, Mr. Burke served as President, Worldwide Services Division of ePresence, formerly Banyan Systems, an online security and identity management company. Mr. Burke is 50 years old.
Mary E. Makela	Ms. Makela has served as a director since July 2002. Since 1994, Ms. Makela has provided management consulting services to Chief Executive Officers, and various for profit and non-profit boards of directors. Ms. Makela formerly served as President of Cognos Corporation and President and Chief Executive Officer of IMC Systems. Ms. Makela is 62 years old.

We expect that Mr. Brochu, Mr. Burke and Ms. Makela will be able to serve if elected. If any of them is not able to serve, proxies may be voted for a substitute nominee.

The nominees receiving the greatest number of votes cast will be elected as directors. We will not count abstentions when we tabulate votes cast for the director election. Brokers have discretionary voting power with respect to director elections.

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Our board of directors recommends that you vote FOR the election of Mr. Brochu, Mr. Burke and Ms. Makela.

Other Matters

Our board of directors is not aware of any matters that are expected to come before the meeting other than those referred to in this proxy statement. If any other matter should properly come before the meeting, the persons named in the accompanying proxy card intend to vote the proxies in accordance with their best judgment.

Submission of Future Stockholder Proposals

Under SEC rules, a stockholder who intends to present a proposal, including nomination of a director, at our 2006 Annual Meeting of Stockholders and who wishes the proposal to be included in the proxy statement for that meeting must submit the proposal in writing to our Secretary at 25 First Street, Cambridge, Massachusetts 02141, prior to December 19, 2005. SEC rules set standards for the types of stockholder proposals and the information that must be provided by the stockholder making the request.

A stockholder may also submit a proposal to be considered at our 2006 Annual Meeting of Stockholders pursuant to our by-laws, which provide that the proposal must be received by our Secretary not less than sixty days nor more than ninety days prior to that meeting. This notice must include the information required by the provisions of our by-laws, a copy of which may be obtained by writing to our Secretary at the address specified above. We have not yet set a date for our 2006 Annual Meeting. If the 2006 Annual Meeting were to be held on May 19, 2006, the Friday before the anniversary of the 2005 Annual Meeting, the deadline for delivery of a stockholder proposal pursuant to our by-laws would be March 21, 2005. If a proposal is submitted in compliance with our by-laws but after December 19, 2005, the stockholder may not require that the proposal be included in the proxy statement for the 2005 Annual Meeting.

INFORMATION ABOUT CONTINUING DIRECTORS AND EXECUTIVE OFFICERS

Background Information about Directors Continuing in Office

Our Class I and Class II directors will continue in office following the meeting. The terms of our Class I directors will expire upon our 2006 Annual Meeting of Stockholders, and the terms of our Class II directors will expire upon our 2007 Annual Meeting of Stockholders. Brief biographies of these directors follow. You will find information about their stock holdings on page 21.

Class I Directors

John R. Held	Mr. Held has been a director since July 2002. Mr. Held formerly served as both the President and Chief Executive Officer of Chipcom, and served in a variety of management positions during his 14-year tenure at Genrad. Mr. Held is a director of BNS Co. Mr. Held is 66 years old.

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Paul G. Shorthose	Mr. Shorthose has been a director since October 2001 and Chairman of the Board of Directors since July 2002. Since January 2004, Mr. Shorthose has been President of ProActive Community, a company that assists non-profit organizations. Mr. Shorthose served as our Chief Executive Officer from October 2001 to December 2002, as our President from February 2000 through December 2002 and as our Chief Operating Officer from June 1999 to October 2001. Mr. Shorthose is 47 years old.
Phyllis S. Swersky	Ms. Swersky has been a director since May 2000. Since 1995 she has been President of The Meltech Group, a consulting firm specializing in business advisory services for high-growth potential businesses. Ms. Swersky also serves as a director of Investor Financial Services, a service provider for the financial services industry. Ms. Swersky is 53 years old.

Class II Directors

David B. Elsbree	Mr. Elsbree has been a director since June 2004. From June 1981 to May 2004, Mr. Elsbree was a partner at Deloitte & Touche. He has been a member of the Board of the New England Chapter of the National Association of Corporate Directors. Mr. Elsbree is 57 years old.
Ilene H. Lang	Ms. Lang has served as a director since October 2001. Since September 2003, Ms. Lang has been president of Catalyst, Inc., an organization that works to advance women in business. From May 2000 to August 2003, Ms. Lang was a business and financial consultant to various boards of directors, boards of trustees, and Chief Executive Officers. From May 1999 to May 2000, she served as President and Chief Executive Officer of Individual.com, Inc., an Internet media service provider. Ms. Lang also serves as a director of Adaptec, Inc., a data storage solutions company. Ms. Lang is 61 years old.
Daniel C. Regis	Mr. Regis has served as a director since November 2004, when he was added to our board in connection with our acquisition of Primus Knowledge Solutions, Inc. Mr. Regis served on Primus board of directors from April 2003 until our acquisition of Primus in November 2004. Mr. Regis presently serves as a Managing Director of Digital Partners, a mid-sized venture capital fund specializing in Northwest emerging technology companies. Mr. Regis is a member of the board of directors of Cray, Inc. and Columbia Banking Systems, Inc. Mr. Regis is 65 years old.

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Information about Executive Officers

Our executive officers are elected by our board of directors. Brief biographies of our current executive officers follow. You will find information about their stock holdings on page 21.

Robert D. Burke	Chief Executive Officer and President. You will find background information about Mr. Burke on page 3.
Edward Terino	Mr. Terino has been Chief Financial Officer and Senior Vice President and Chief Financial Officer since October 2001. In accordance with the terms of our letter agreement with Mr. Terino described on p. 20, Mr. Terino will serve as our Chief Financial Officer until the earlier of May 31, 2005 or the date that we appoint a new chief financial officer. From April 1999 to September 2001, he was Chief Financial Officer of Applix, Inc., a provider of enterprise-wide software solutions. Mr. Terino is 51 years old.
Barry Clark	Mr. Clark has been Senior Vice President Worldwide Sales since February 2004. From February 2002 to February 2004, Mr. Clark was President of SchoolKidz, Inc., a packaged school supply retailer. From October 1998 to December 2001, Mr. Clark was Division President of Domino Amjet, a company that offers coding and printing solutions using ink jet and laser technologies. Mr. Clark is 48 years old.
Cliff Conneighton	Mr. Conneighton has been Senior Vice President of Marketing since December 2003. From December 2001 until December 2003 Mr. Conneighton was an author, as well as a consultant at Conneighton Group, LLC, a privately held management consulting firm. Mr. Conneighton was a founder of iCOMS, Inc., an independent e-commerce service provider. He served as its Chief Executive Officer from January 1997 to December 1999 and from January 2001 to December 2001, and as its Chief Marketing Officer from January 2000 to December 2000. Mr. Conneighton is 55 years old.
Patricia O Neill	Ms. O Neill has been Senior Vice President Human Resources since January 2004. From May 2000 to January 2004, Ms. O Neill served as our Vice President Human Resources. From April 1995 to February 2000 Ms. O Neill was the Vice President Human Resources of The Shareholder s Services Group, a division of First Data Corporation. Ms. O Neill is 56 years old.
Kenneth Z. Volpe	Mr. Volpe has been Senior Vice President, Products and Technology since September 2004. From November 2003 to September 2004, Mr. Volpe served as our Vice President and General Manger, Platform Products. From June 1999 to November 2003, he served as our Vice President, Product Management, and from September 1998 to June 1999, he served as our Director, Product Management. Mr. Volpe is 39 years old.

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INFORMATION ABOUT CORPORATE GOVERNANCE

General

We believe that good corporate governance is important to ensure that Art Technology Group, Inc. is managed for the long-term benefit of our stockholders. During the past year, we have continued to review our corporate governance policies and practices and to compare them to those suggested by various authorities in corporate governance and the practices of other public companies. We have also continued to review the provisions of the Sarbanes-Oxley Act of 2002, the new and proposed rules of the Securities and Exchange Commission and the new listing standards of Nasdaq. For example, in December 2004 our board of directors engaged independent corporate governance experts to evaluate our corporate governance structure, policies and procedures, and we have begun implementing some of the suggestions made by these studies.

Board and Committee Meetings

The board of directors has responsibility for establishing broad corporate policies and reviewing our overall performance rather than day-to-day operations. The board s primary responsibility is to oversee our management and, in so doing, serve the best interests of the company and its stockholders. The board selects, evaluates and provides for the succession of executive officers and, subject to stockholder election, directors. It reviews and approves corporate objectives and strategies, and evaluates significant policies and proposed major commitments of corporate resources. Management keeps the directors informed of our activities through regular written reports and presentations at board and committee meetings.

Our board met in person or via teleconference 21 times in 2004. During 2004, each director attended at least 75 percent of the total number of meetings held by the board and the committees of the board on which he or she served at the time of such meeting. The board has established three standing committees Audit, Compensation, and Nominating and Governance each of which operates under a charter that has been approved by the board. Current copies of each committee s charter are posted on the about ATG Management Team Board Committees section of our website, *www.atg.com*. In addition, a copy of the Amended and Restated Audit Committee Charter, as in effect on the date of this proxy statement, can be found as Appendix C to the proxy statement we filed with the Securities and Exchange Commission in April 2004 relating to our 2004 annual meeting of stockholders.

The board has determined that all of the members of the board s Audit Committee, Compensation Committee and Nominating and Governance Committee meet the independence requirements of the Nasdaq Stock Market for membership on the committees on which he or she serves.

Audit Committee

The Audit Committee s responsibilities include:

- appointing, evaluating, approving the compensation of, and assessing the independence of the our independent registered public accounting firm;

- overseeing the work of our independent registered public accounting firm, which includes the receipt and consideration of certain reports from our independent registered public accounting firm;
- reviewing and discussing with management and our independent registered public accounting firm our annual and quarterly financial statements and related disclosures;
- monitoring our internal controls over financial reporting and disclosure controls and procedures;
- establishing procedures for the receipt and retention of accounting related complaints and concerns;
- meeting independently with our independent registered public accounting firm and management; and
- preparing the audit committee report required by SEC rules (which is included on page 11 of this proxy statement).

The Audit Committee met in person or via teleconference fourteen times during 2004. The current Audit Committee members are Mr. Elsbree, Ms. Makela and Mr. Regis, with Mr. Elsbree serving as the Chair of the committee. The board of directors has determined that Mr. Elsbree is an audit committee financial expert as defined in Item 401(h) of Regulation S-K.

Compensation Committee

The Compensation Committee s responsibilities include:

- annually reviewing and approving corporate goals and objectives relevant to chief executive officer compensation;
- determining the chief executive officer s compensation;
- reviewing and approving, or making recommendations to the board with respect to, the compensation of our other executive officers;
- overseeing and administering our cash and equity incentive plans; and
- reviewing and making recommendations to the board with respect to director compensation.

The Compensation Committee met nine times during 2004. The current members of the Compensation Committee are Mr. Held, Ms. Makela and Ms. Swersky, with Ms. Makela serving as the Chair of the committee.

Nominating and Governance Committee

The Nominating and Governance Committee s responsibilities include:

- identifying individuals qualified to become members of the board of directors;
- recommending to the board the persons to be nominated for election as directors;
- recommending directors for each committee of the board;

developing and recommending to the board corporate governance principles; and

overseeing the evaluation of the board.

The Nominating and Governance Committee met six times during 2004. The Nominating and Governance Committee s current members are Mr. Held, Ms. Lang and Ms. Swersky, with Ms. Swersky serving as the Chair of the committee.

Director Candidates

The process followed by the Nominating and Governance Committee to identify and evaluate director candidates includes requests to members of the board of directors and others for recommendations, meetings from time to time to evaluate biographical information and background material relating to potential candidates and interviews of selected candidates by members of the Nominating and Governance Committee and the board. In addition, the Nominating and Governance Committee is authorized to retain and in 2004 retained the services of a search firm to help identify and evaluate potential director candidates.

In considering whether to recommend any particular candidate for inclusion in the board s slate of recommended director nominees, the Nominating and Governance Committee will apply the written criteria established by the board. These criteria include the candidate s integrity, business acumen, knowledge of our business and industry, experience, diligence, conflicts of interest and the ability to act in the interests of all stockholders. The Nominating and Governance Committee does not assign specific weights to particular criteria and no particular criterion is a prerequisite for each prospective nominee. We believe that the backgrounds and qualifications of our directors, considered as a group, should provide a composite mix of experience, knowledge and abilities that will allow the board to fulfill its responsibilities.

Stockholders may recommend individuals to the Nominating and Governance Committee for consideration as potential director candidates by submitting their names, together with appropriate biographical information and background materials and a statement as to whether the stockholder or group of stockholders making the recommendation has beneficially owned more than 5% of our common stock for at least a year as of the date such recommendation is made, to Nominating and Governance Committee, c/o Secretary, Art Technology Group, Inc., 25 First Street, Cambridge, Massachusetts 02141. Assuming that appropriate biographical and background material has been provided on a timely basis, the Nominating and Governance Committee will evaluate stockholder-recommended candidates by following substantially the same process, and applying substantially the same criteria, as it follows for candidates submitted by others. If the board determines to nominate a stockholder-recommended candidate and recommends his or her election, then his or her name will be included in our proxy card for the next annual meeting.

Stockholder Communications and Annual Meeting Attendance

The board of directors will give appropriate attention to written communications that are submitted by stockholders, and will respond if and as appropriate. Absent unusual circumstances or as contemplated by committee charters and subject to any required assistance or advice, the Chairperson of the Nominating and Governance Committee is primarily responsible for monitoring communications from stockholders and for providing copies or summaries of such communications to the other directors as she considers appropriate.

Communications are forwarded to all directors if they relate to important substantive matters and include suggestions or comments that the Chairperson of the Nominating and Governance Committee considers to be important for the directors to know. In general, communications relating to corporate governance and long-term corporate strategy are more likely to be forwarded than communications relating to ordinary business affairs or personal grievances, or matters as to which we have received repetitive or duplicative communications.

Stockholders who wish to send communications on any topic to the Board should address such communications to Chairperson of the Nominating and Governance Committee c/o Secretary, Art Technology Group, Inc., 25 First Street, Cambridge, Massachusetts 02141.

Of the directors who were members of the board of directors at the time of our annual meeting of shareholders for 2004, half attended the annual meeting.

Code of Business Conduct and Ethics

We have adopted a Code of Business Conduct and Ethics that applies to all of our directors, officers and employees, including our principal executive officer, principal financial officer and principal accounting officer or controller. Our Code of Business Conduct and Ethics is posted on the about ATG Legal Information Code of Conduct section of our website, *www.atg.com*, and a copy is available without charge upon request to Secretary, Art Technology Group, Inc., 25 First Street, Cambridge, Massachusetts 02141.

Information regarding any amendments to, or waivers from, the Code of Business Conduct and Ethics will be posted on the about ATG Legal Information Code of Conduct section of our website, *www.atg.com*.

Compensation of Directors

In 2004, pursuant to our 2004 Outside Director Compensation Plan for non-employee directors:

- we paid an annual retainer of $12,500 to our non-employee directors; $2,500 of which was paid in the form of restricted stock;

- we made additional payments of $1,500 for each in-person meeting of the board attended by non-employee directors and $1,000 for each in person meeting of a committee of the board attended by non-employee directors and $500 for each teleconference meeting of the board or a committee of the board attended by non-employee directors;

- in order to compensate committee chairpersons for the additional work imposed by these roles, we provided an additional retainer of $1,875 per full fiscal quarter to each non-employee committee chairperson;

we reimbursed directors living outside of the greater Boston area for travel and living expenses for attending regular board meetings and committee meetings; and

we granted each of our continuing non-employee directors, pursuant to our 1999 Director Stock Option Plan, an option to purchase 25,000 shares of common stock at an exercise price equal to the fair market value of our common stock on the date of grant, vesting quarterly over one year.

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information as of April 4, 2005 about the securities authorized for issuance under our equity compensation plans, consisting of our Amended and Restated 1996 Stock Option Plan, our Amended and Restated 1999 Outside Director Stock Option Plan, our Amended and Restated 1999 Employee Stock Purchase Plan, our Primus 1999 Non-officer Stock Option Plan and our Primus 1999 Stock Incentive Compensation Plan.

Plan category	(a) Number of shares to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of shares remaining available for future issuance under equity compensation plans (excluding shares reflected in column (a))
Equity compensation plans approved by stockholders(1)	14,227,305	$ 3.12	11,711,564(3)
Equity compensation plans not approved by stockholders(2)	1,008,754	$ 0.69	
Total	15,236,059	$ 2.96	11,711,564

(1) Includes the Primus 1999 Stock Incentive Plan, which was assumed as part of our acquisition of Primus Knowledge Solutions, Inc. and was approved by Primus stockholders. Under this plan, there are currently outstanding options to purchase 3,681,756 shares of our common stock at a weighted average exercise price of $0.79. In addition, there are 2,359,307 shares remaining available for future issuance under this plan.

(2) Consists of the Primus 1999 Non-Officer Stock Option Plan, which was assumed as part of our acquisition of Primus Knowledge Solutions, Inc. and was not approved by Primus stockholders.

(3) Includes 852,000 shares of common stock reserved for future issuance under our Amended and Restated 1999 Employee Stock Purchase Plan

Audit Committee Report

The Audit Committee reviewed the audited financial statements for the year ended, and as of, December 31, 2004 and discussed these financial statements with management. This report is made by the members of the Audit Committee during the time of this review of the audited financial statements. The Audit Committee also reviewed and discussed the audited financial statements and the matters required by Statement on Auditing Standards 61, *Communication*

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with Audit Committees, or SAS 61, with Ernst & Young LLP, our independent registered public accounting firm for 2004. SAS 61 requires Ernst & Young to discuss with our Audit Committee, among other things, the following:

- methods used to account for significant unusual transactions;
- the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus;
- the process used by management in formulating particularly sensitive accounting estimates and the basis for the auditors conclusions regarding the reasonableness of those estimates; and
- disagreements, of which there were none, with management about financial accounting and reporting matters and audit procedures.

Ernst & Young also provided the Audit Committee with the written disclosures and the letter required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*. This Standard requires auditors annually to disclose in writing all relationships that in the auditors professional opinion may reasonably be thought to bear on independence, confirm their perceived independence and engage in a discussion of independence. In addition, the Audit Committee discussed with Ernst & Young the independence of Ernst & Young from the company, and considered whether Ernst & Young s provision of other, non-audit related services, which are described below under Independent Registered Public Accounting Firm s Fees, is compatible with maintaining such independence.

Based on its discussions with management and Ernst & Young, and its review of the representations and information provided by management and Ernst & Young, the Audit Committee recommended to the board that the audited financial statements be included in the annual report on Form 10-K for the year ended December 31, 2004.

Audit Committee

David B. Elsbree, Chair
Ilene H. Lang
Mary E. Makela

Principal Accountant Fees and Services

Our Audit Committee has selected Ernst & Young LLP to serve as our independent registered public accounting firm for the year ending December 31, 2005. Ernst & Young has served as our independent registered public accounting firm since 2002. We expect that representatives of Ernst & Young will be present at the meeting to answer appropriate questions. They will have the opportunity to make a statement if they desire to do so.

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Independent Registered Public Accounting Firm s Fees

The following table summarizes the fees that Ernst & Young LLP billed to us for each of the last two fiscal years for audit services and billed to us in each of the last two fiscal years for other services:

	Fees	
Fee Category	**Fiscal 2004**	**Fiscal 2003**
Audit fees	$ 1,098,300	$ 508,500
Audit-related fees	81,100	2,400
Tax fees	84,700	154,000
All other fees		3,400
Total fees	$ 1,264,100	$ 668,300

Audit fees. Audit fees consist of fees for the audit of our consolidated financial statements, the review of the interim financial statements included in our quarterly reports on Form 10-Q, and other professional services provided in connection with statutory and regulatory filings or engagements. For 2004, these services included Ernst & Young s examination and evaluation of our internal controls in response to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 and related regulations, which accounted for $476,100 of the audit fees for 2004. Also for fiscal 2004, Ernst & Young performed audit services in connection with several registration statements.

Audit-related fees. Audit-related fees consist of fees for assurance and related services that are reasonably related to the performance of the audit and the review of our financial statements and that are not reported under Audit Fees. These services relate to due diligence and accounting consultation related to mergers and acquisitions and internal control assistance.

Tax fees. Tax fees consist of fees for tax compliance, tax advice and tax planning services. Tax compliance services, which relate to preparation and review of original and amended tax returns, claims for refunds and tax payment-planning services, accounted for $29,700 of the total tax fees paid for in 2004 and $22,600 of the total tax fees paid for 2003. Tax advice and tax planning services relate to expatriate tax services, transfer pricing studies and miscellaneous items.

All other fees. All other fees consist of fees for the assistance with preparing and reviewing an administrative statutory filing.

Pre-Approval Policy and Procedures

The Audit Committee has adopted policies and procedures relating to the approval of all audit and non-audit services that are to be performed by our independent registered public accounting firm. These policies generally provide that we will not engage our independent registered public accounting firm to render audit or non-audit services unless the service is specifically approved in advance by the Audit Committee or the engagement is entered into pursuant to one of the pre-approval procedures described below.

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From time to time, the Audit Committee may pre-approve specified types of services that are expected to be provided to us by our independent registered public accounting firm during the next 12 months. Any such pre-approval is detailed as to the particular service or type of services to be provided and is also generally subject to a maximum dollar amount.

Related Party Transactions

On November 20, 2001 we loaned Edward Terino, our Chief Financial Officer, a total of $150,000 pursuant to a note that bears interest at an annual rate of 5.0%. The principal and all interest accruing on the note are payable on November 20, 2005 or such earlier date on which Mr. Terino ceases working for us. The note may be paid by Mr. Terino at any time without penalty. The note is not subject to redemption to us prior to maturity. Mr. Terino s largest aggregate indebtedness to us during 2004 was $174,367 as of December 31, 2004. As of March 31, 2005, Mr. Terino s aggregate indebtedness to us was $176,556.

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EXECUTIVE COMPENSATION

Summary Compensation

The following table sets forth information with respect to the annual and long-term compensation that we paid for the past three years to the following persons, who are referred to as our named executive officers:

Robert D. Burke, our chief executive officer; and

Edward Terino, Cliff Conneighton, Patricia Gilligan and Philip E. London, our four other most highly compensated executive officers as of December 31, 2004.

Summary Compensation Table

Name and Principal Position			Year		Annual Compensation Salary ($)	Annual Compensation Bonus ($)	Annual Compensation Other Annual Compensation ($)	Long-Term Compensation Awards Securities Underlying Options (#)	All Other Compensation ($)
Robert D. Burke			2004		$ 350,000	$ 41,234		225,000	
	President and Chief		2003		350,000	43,750		400,000	
	Executive Officer		2002		16,177			500,000	
Edward Terino			2004		250,000				
Other comprehensive income (loss), net of tax:									
Change in foreign currency translation gain (loss), net of tax		238		(521)					
Change in unrealized gain (loss) on available-for-sale investments, net of tax		(259)		(10)					
Total other comprehensive loss, net of tax		(21)		(531)					
Comprehensive loss		(920)		(2,366)					
Less: Comprehensive income attributable to the noncontrolling interests		(157)		(126)					
Comprehensive loss attributable to AXT, Inc.	$	(1,077)		$(2,492)					

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Three Months Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net loss	$(899)	$(1,835)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,403	1,404
Amortization of marketable securities premium	55	122
Stock-based compensation	274	292
Loss (gain) on disposal of property, plant and equipment	9	(5)
Provision for doubtful accounts	150	1
Realized gain on sale of investments	(367)	—
Changes in assets and liabilities:		
Accounts receivable, net	(1,052)	(1,459)
Inventories	(858)	985
Prepaid expenses and other current assets	1,124	1,584
Other assets	(151)	18
Accounts payable	1,979	(489)
Accrued liabilities	(1,906)*	(697)*
Other long-term liabilities	(110)	(308)
Net cash used in operating activities	(349)	(387)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(676)	(163)
Proceeds from sales of property, plant and equipment	2	5
Purchases of available-for-sale securities	(4,304)	(3,725)
Proceeds from sales and maturities of available-for-sale securities	10,277	2,180
Net cash provided by (used in) investing activities	5,299	(1,703)
Cash flows from financing activities:		
Proceeds from common stock options exercised	76	—
Repurchase of the Company’s common stock, including commission	(617)	—
Net cash used in financing activities	(541)	—
Effect of exchange rate changes on cash and cash equivalents	62	(111)
Net increase (decrease) in cash and cash equivalents	4,471	(2,201)
Cash and cash equivalents at the beginning of the period	28,814	24,961
Cash and cash equivalents at the end of the period	$33,285	$22,760

*Dividends accrued but not paid by joint ventures of $646 and $729 was included in accrued liabilities as of March 31, 2015 and March 31, 2014, respectively.

See accompanying notes to condensed consolidated financial statements.

AXT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements of AXT, Inc. ("AXT," the "Company," "we," "us," and "our refer to AXT, Inc. and all of its consolidated subsidiaries) are unaudited, and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the year-end condensed consolidated balance sheet data was derived from our audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of our management, the unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, considered necessary to present fairly the financial position, results of operations and cash flows of AXT and our consolidated subsidiaries for all periods presented.

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

The results of operations are not necessarily indicative of the results to be expected in the future or for the full fiscal year. It is recommended that these condensed consolidated financial statements be read in conjunction with our consolidated financial statements and the notes thereto included in our 2014 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC") on March 13, 2015.

The consolidated financial statements include the accounts of AXT, our wholly-owned subsidiary, Beijing Tongmei Xtal Technology Co., Ltd., and our majority-owned subsidiaries, Beijing JiYa Semiconductor Material Co., Ltd., Nanjing Jin Mei Gallium Co., Ltd. and Beijing BoYu Semiconductor Vessel Craftwork Technology Co., Ltd. All significant inter company accounts and transactions have been eliminated. Investments in business entities in which we do not have control, but have the ability to exercise significant influence over operating and financial policies (generally 20-50% ownership), are accounted for by the equity method. For majority-owned subsidiaries, we reflect the noncontrolling interest of the portion we do not own on our condensed consolidated balance sheets in stockholders' equity and in our condensed consolidated statements of operations.

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Note 2. Investments and Fair Value Measurements

Our cash and cash equivalents consist of cash and instruments with original maturities of less than 90 days. Our investments consist of instruments with original maturities of more than 90 days. As of March 31, 2015 and December 31, 2014, our cash, cash equivalents and investments are classified as follows (in thousands):

	March 31, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value
Classified as:								
Cash	$25,662	$ —	$ —	$25,662	$22,337	$ —	$ —	$22,337
Cash equivalents:								
Certificates of deposit[1]	7,623	—	—	7,623	6,454	—	—	6,454
Money market fund	—	—	—	—	23	—	—	23
Total cash and cash equivalents	33,285	—	—	33,285	28,814	—	—	28,814
Investments (available for sale):								
Certificates of deposit[2]	6,425	1	(7)	6,419	10,195	1	(13)	10,183
Corporate bonds	7,342	—	(31)	7,311	9,214	1	(29)	9,186
Corporate equity security	24	448	—	472	44	710	—	754
Total investments	13,791	449	(38)	14,202	19,453	712	(42)	20,123
Total cash, cash equivalents and investments	$47,076	$ 449	$ (38)	$47,487	$48,267	$ 712	$ (42)	$48,937
Contractual maturities on investments:								
Due within 1 year	$3,144			$3,590	$11,631			$12,340
Due after 1 through 5 years	10,647			10,612	7,822			7,783
	$13,791			$14,202	$19,453			$20,123

1. Certificate of deposit with original maturities of less than 90 days.
2. Certificate of deposit with original maturities of more than 90 days.

We manage our investments as a single portfolio of highly marketable securities that is intended to be available to meet our current cash requirements. We have no investments in auction rate securities. Certificates of Deposit and Corporate bonds are typically held until maturity. Corporate equity securities have no maturity and may be sold at any time. Our current holding of corporate equity securities consists of the common stock of Intelligent Epitaxy Technology, Inc ("IntelliEPI"), a Taiwan publicly-traded company. During the three months ended March 31, 2015, we sold some of our IntelliEpi stock. From this, our cash proceeds from sales of available-for-sale investments was $387,000. Our cost was $20,000 and our gross realized gain from sales of available-for-sale investments was $367,000.There were no sales of available-for-sale securities and no realized gains and losses for the three months ended March 31, 2014.

We began classifying IntelliEpi stock as an available-for-sale security upon its initial public offering in 2013. An unrealized gain of $448,000 net of tax remains as of March 31, 2015 for IntelliEpi stock still held. These securities are valued at fair market value at March 31, 2015 and December 31, 2014. There is no assurance that we will realize this value when the securities are sold in the future.

The gross unrealized losses related to our portfolio of available-for-sale securities were primarily due to changes in interest rates and market and credit conditions of the underlying securities. We have determined that the gross unrealized losses on some of our available-for-sale securities as of March 31, 2015 are temporary in nature. We periodically review our investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is temporary include the magnitude of the decline in market value, the length of time the market value has been below cost (or adjusted cost), credit quality, and our ability and intent to hold the securities for a period of time sufficient to allow for any anticipated recovery in market value.

A portion of our investments would generate a loss if we sold them on March 31, 2015. The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of March 31, 2015 (in thousands):

As of March 31,2015	In Loss Position < 12 months		In Loss Position > 12 months		Total In Loss Position	
	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)
Investments:						
Certificates of deposit	$4,018	$ (7)	$480	$ —	$4,498	$ (7)
Corporate bonds	7,311	(31)	—	—	7,311	(31)
Total in loss position	$11,329	$ (38)	$480	$ —	$11,8109	$ (38)

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The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2014 (in thousands):

As of December 31, 2014	In Loss Position < 12 months		In Loss Position > 12 months		Total In Loss Position	
	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)
Investments:						
Certificates of deposit	$4,492	$ (13)	$—	$ —	$4,492	$ (13)
Corporate bonds	3,770	(27)	4,309	(2)	8,079	(29)
Total in loss position	$8,262	$ (40)	$4,309	$ (2)	$12,571	$ (42)

Investments in Privately-held Companies

We have made strategic investments in private companies located in China in order to gain access at a competitive cost to raw materials that are critical to our substrate business (see Note 6). The investment balances for all of these companies, including minority investments indirectly in privately-held companies made by our consolidated subsidiaries, accounted for under the equity method are included in “other assets” in the consolidated balance sheets and totaled $12.5 million and $12.1 million as of March 31, 2015 and December 31, 2014, respectively.

We also maintain minority investments in one company which is accounted for under the cost method as we do not have the ability to exercise significant influence over their operations. Our investments under the cost method are reviewed for other than temporary declines in value on a quarterly basis. We monitor our investments for impairment and record reductions in carrying value when events or changes in circumstances indicate that the carrying value may not be recoverable. As of March 31, 2015 and December 31, 2014, our investments in this unconsolidated company had a carrying value of $200,000 and were also included in “other assets” in the condensed consolidated balance sheets.

Fair Value Measurements

ASC topic 820, Fair value measurement (“ASC 820”) establishes three levels of inputs that may be used to measure fair value. Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets of the asset or identical assets. Level 2 instrument valuations are obtained from readily-available pricing sources for comparable instruments. Level 3 instrument valuations are obtained from unobservable inputs in which there is little or no market data, which require us to develop our own assumptions. On a recurring basis, we measure certain financial assets and liabilities at fair value, primarily consisting of our short-term and long-term investments.

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

We place short term foreign currency hedges that are intended to offset the potential cash exposure related to fluctuations in the exchange rate between the United States dollar and Japanese yen. We measure the fair value of these foreign currency hedges at each month end and quarter end using current exchange rates and in accordance with generally accepted accounting principles. At quarter end any foreign currency hedges not settled are netted in “accrued liabilities” on the consolidated balance sheet and classified as Level 3 assets and liabilities. As of March 31, 2015 the net change in fair value from the placement of the hedge to settlement at each month end during the quarter had a de minimis impact to the consolidated results.

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There were no changes in valuation techniques or related inputs in the three months ended March 31, 2015. There have been no transfers between fair value measurement levels during the three months ended March 31, 2015.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 as of March 31, 2015 (in thousands):

	Balance as of March 31, 2015	Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents and investments:				
Certificates of deposit	$14,042	$ —	$ 14,042	$ —
Corporate bonds	7,311	—	7,311	—
Corporate equity securities	472	472	—	—
Total	$21,825	$ 472	$ 21,353	$ —
Liabilities:				
Foreign currency hedge obligations	$2	$ —	$ —	$ 2

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 as of December 31, 2014 (in thousands):

	Balance as of December 31, 2014	Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents and investments:				
Money market fund	$ 23	$ 23	$ —	$ —
Certificates of deposit	10,183	—	10,183	—
Corporate bonds	9,186	—	9,186	—
Corporate equity securities	754	754	—	—
Total	$ 20,146	$ 777	$ 19,369	$ —
Liabilities	$ —	$ —	$ —	$ —

Items Measured at Fair Value on a Nonrecurring Basis

Certain assets that are subject to nonrecurring fair value measurements are not included in the table above. These assets include investments in privately-held companies accounted for by equity and cost method (See Note 6). We did not record other-than-temporary impairment charges for either of these investments during the three months ended

March 31, 2015 or 2014.

Note 3. Inventories

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

	March 31, 2015	December 31, 2014
Inventories:		
Raw materials	$19,688	$ 18,990
Work in process	16,948	16,222
Finished goods	2,839	3,362
	$39,475	$ 38,574

As of March 31, 2015 and December 31, 2014, carrying values of inventories were net of inventory reserve of $11.4 million and $11.2 million, respectively, for excess and obsolete inventory.

Note 4. Accrued Liabilities

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

	March 31, 2015	December 31, 2014
Accrued product warranty	$392	$ 802
Accrued compensation and related charges	1,718	2,656
Current portion of royalty payments	744	800
Dividends payable by consolidated joint ventures	646	563
Accrued professional services	304	509
Accrued income taxes	110	119
Other accrued liabilities	1,901	2,185
	$5,815	$ 7,634

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Note 5. Related Party Transactions

In August 2011, our consolidated joint venture, Beijing JiYa Semiconductor Material Co., Ltd. (“JiYa”), entered into a non-interest bearing note agreement in the amount of $1.7 million for a loan to one of its equity investment entities. The original term of the loan was for two years and ten months with 3 periodic principal payments required. After various amendments to the terms of the note, in December 2013 the parties agreed to delay all principal repayment until December 2016. As of March 31, 2015, and December 31, 2014, we included $1.7 million in “Related party notes receivable – long term” in our condensed consolidated balance sheets.

JiYa also purchases raw materials from one of its equity investment entities for production in the ordinary course of business. As of March 31, 2015 and December 31, 2014, amounts payable of $1.8 million were included in “accounts payable” in our condensed consolidated balance sheets.

JiYa also sells raw materials to one of its equity investment entities for production in the ordinary course of business. As of March 31, 2015 and December 31, 2014, amounts receivable of $350,000 were included in “accounts receivable” in our condensed consolidated balance sheets.

Beginning in 2012, our consolidated joint venture, Nanjing Jin Mei Gallium Co., Ltd. (“Jin Mei”), is contractually obligated under an agency sales agreement to sell raw material on behalf of its equity investment entity. Jin Mei bills the customers and remits the receipts, net of its portions of sales commission, to this equity investment entity. For the three months ended March 31, 2015 and 2014, Jin Mei has recorded $1,000 and $5,000 income from agency sales, respectively, which were included in “other income (expense), net” in the condensed consolidated statements of operations.

In March 2012, our wholly-owned subsidiary, Beijing Tongmei Xtal Technology Co., Ltd. (“Tongmei”), entered into an operating lease for the land it owns with our consolidated joint venture Beijing BoYu Semiconductor Vessel Craftwork Technology Co., Ltd. The lease agreement for the land of approximately 22,081 square feet commenced on January 1, 2012 for a term of 10 years with annual lease payments of $24,000 subject to a 5% increase at each third year anniversary. The annual lease payment is due by January 31 of each year.

Tongmei has paid $121,000 on behalf of Donghai County Dongfang High Purity Electronic Materials Co., Ltd.(“Dongfang”), its equity investment entity, to purchase materials. In 2014, an agreement was signed between Tongmei and Dongfang to set the date of repayment on December 31, 2015. As of March 31, 2015, this balance was included in “Related party notes receivable – short term” in our condensed consolidated balance sheets.

In April 2014, Tongmei loaned an additional of $49,000 to Dongfang. The loan bears interest at 6.15% per annum and the principal and interest totaling $52,000 as of March 31, 2015 is due on December 31, 2015. As of March 31, 2015, this balance, including both principal and interest, was included in “Related party notes receivable – short term” in our condensed consolidated balance sheets.

Tongmei also purchases raw materials from one of our equity investment entities for production in the ordinary course of business. As of March 31, 2015 and December 31 2014, amounts payable of $465,000 and $513,000, respectively, were included in “accounts payable” in our condensed consolidated balance sheets.

Beijing Kaide Quartz Co. Ltd. (“Kaide”) has been a supplier of customized quartz tubes to the Company since 2004. Beijing XiangHeMing Trade Co. Ltd., (“XiangHeMing”) is a significant shareholder of Kaide. XiangHeMing was previously owned by, among others, certain immediate family members of Davis Zhang, our President, China Operations, until at least sometime in 2004, at which time the official Chinese government records indicate that Mr. Zhang’s immediate family members transferred their ownership of XiangHeMing to a third party. However, we are currently unable to conclusively determine whether Mr. Zhang’s immediate family members retained any economic interest in XiangHeMing after the transfer. As of March 31, 2015 and December 31 2014, amounts payable of $637,000 and $730,000, respectively, were included in “accounts payable” in our condensed consolidated balance sheets.

Our Related Party Transactions Policy seeks to prohibit all conflicts of interest in transactions between related parties and us, unless they have been approved by our Board of Directors. This policy applies to all of our employees and directors, our subsidiaries and our joint ventures. Our executive officers retain board seats on the board of directors of the companies in which we have invested in our China joint ventures. See Note 6 for further details.

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Note 6. Investments in Privately-held Companies

We have made strategic investments in private companies located in China in order to gain access at a competitive cost to raw materials that are critical to our substrate business. These companies form part of our overall supply chain.

Our investments are summarized below (in thousands):

Company	Investment Balance as of March 31, 2015	Investment Balance as of December 31, 2014	Accounting Method	Ownership Percentage
Beijing JiYa Semiconductor Material Co., Ltd.	$3,331	$ 3,331	Consolidated	46 %
Nanjing Jin Mei Gallium Co., Ltd.	592	592	Consolidated	83 %
Beijing BoYu Semiconductor Vessel Craftwork Technology Co., Ltd.	1,346	1,346	Consolidated	70 %
	$5,269	$ 5,269		
Donghai County Dongfang High Purity Electronic Materials Co., Ltd.	$1,682	$ 1,723	Equity	46 %
Xilingol Tongli Germanium Co. Ltd.	5,440	5,351	Equity	25 %
Emeishan Jia Mei High Purity Metals Co., Ltd.	1,025	1,021	Equity	25 %
	$8,147	$ 8,095		

Our ownership of Beijing JiYa Semiconductor Material Co., Ltd. (JiYa) is 46%. We continue to consolidate JiYa as we have significant influence in management and have majority control of the board. Our Chief Executive Officer is chairman of the JiYa board and two other of our employees are also members of the board.

Our ownership of Nanjing Jin Mei Gallium Co., Ltd. (Jin Mei) is 83%. We continue to consolidate Jin Mei as we have significant influence in management and have majority control of the board. Our Chief Executive Officer is chairman of the Jin Mei board and two other of our employees are also members of the board.

Our ownership of Beijing BoYu Semiconductor Vessel Craftwork Technology Co., Ltd (BoYu) is 70%. We continue to consolidate BoYu as we have a significant influence in management and have majority control of the board. Our Chief Executive Officer is chairman of the BoYu board and two other of our employees are also members of the board.

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

During the three months ended March 31, 2015 and 2014, the three consolidated joint ventures generated $0.6 million and $0.8 million of income, respectively, of which $125,000 and $205,000, respectively, were allocated to minority interests, resulting in $427,000 and $548,000 of income, respectively, to our net income (loss).

For the three minority investment entities that are not consolidated, the investment balances are included in “other assets” in our consolidated balance sheets and totaled $8.1 million and $8.1 million as of March 31, 2015 and December 31, 2014, respectively. We own 46% of the ownership interests in one of these companies and 25% in each of the other two companies. These three companies are not considered variable interest entities because:

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

We also maintain minority investments indirectly in privately-held companies through our consolidated joint ventures. These minority investments are accounted for under the equity method in the books of our consolidated joint ventures. As of March 31, 2015 and December 31, 2014, our consolidated joint ventures included these minority investments in "other assets" in the consolidated balance sheets with a carrying value of $4.3 million and $4.0 million, respectively.

The minority investment entities that are not consolidated are accounted for under the equity method and had the following summarized income information (in thousands) for the three months ended March 31, 2015 and 2014.

	Three Months Ended March 31, 2015	2014
Revenue	$9,325	$13,480
Gross profit	2,295	3,963
Operating income	1,051	2,664
Net income	957	2,119

Our portion of the entity earnings from the minority investment entities that are not consolidated and are accounted for under the equity method were $200,000 and $487,000 for the three months ended March 31, 2015 and March 31, 2014, respectively.

We also maintain minority investments directly in one privately-held company accounted for under the cost method and we do not have the ability to exercise significant influence over their operations. As of March 31, 2015 and December 31, 2014, our investments in this unconsolidated privately-held company had a carrying value of $200,000 and are included in "other assets" in the condensed consolidated balance sheets.

Note 7. Stockholders' Equity and Stock Repurchase Program

Consolidated Statements of Changes in Equity

	Preferred Stock	Common Stock	Additional Paid In Capital	Accumulated Deficit	Other Comprehensive Income/(loss)	AXT, Inc. stockholders' equity	Noncontrolling interests	Total stockholders' equity
Balance as of December 31, 2014	$ 3,532	$ 32	$ 195,419	$ (68,393)	$ 7,673	$ 138,263	$ 6,425	$ 144,688
Common stock options exercised			76			76		76
Common stock repurchased			(617)			(617)		(617)
Stock-based compensation			274			274		274
Net (loss) income				(1,024)		(1.024)	125	(899)
Dividends declared by joint ventures							(83)	(83)
Change in unrealized (loss) gain on marketable securities					(259)	(259)		(259)
Currency translation adjustment					206	206	32	238
	$ 3,532	$ 32	$ 195,152	$ (69,417)	$ 7,620	$ 136,919	$ 6,499	$ 143,418

Balance as of March 31,
2015

There were no reclassification adjustments from accumulated other comprehensive income for the three months ended March 31, 2015 and March 31, 2014.

Stock Repurchase Programs

On February 21, 2013, our Board of Directors approved a stock repurchase program pursuant to which we may repurchase up to $6.0 million of our outstanding common stock through February 27, 2014. These purchases can be made from time to time in the open market and are funded from our existing cash balances and cash generated from operations. During 2013, we repurchased approximately 285,000 shares at an average price of $2.51 per share for a total purchase price of $716,000 under the stock repurchase program. As of December 31, 2013, approximately $5.3 million remained available for future repurchases under this program. No shares were repurchased in 2014 under this program and the plan expired on February 27, 2014. On October 27, 2014, our Board of Directors approved a stock repurchase program pursuant to which we may repurchase up to $5.0 million of our outstanding common stock. These repurchases can be made from time to time in the open market and are funded from our existing cash balances and cash generated from operations. During the three months ended March 31, 2015, we repurchased approximately 230,000 shares at an average price of $2.67 per share for a total purchase price of $617,000 under the stock repurchase program. As of March 31, 2015, approximately $4.4 million remained available for future repurchases under this program. See Item 2, Unregistered Sales of Equity Securities and Use of Proceeds in Part II, Other Information, for additional information.

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Note 8. Stock-Based Compensation

We account for stock-based compensation in accordance with the provisions of FASB Accounting Standards Codification ("ASC") topic 718, Compensation-Stock Compensation ("ASC 718"), which established accounting for stock-based awards exchanged for employee services. Stock-based compensation cost is measured at each grant date, based on the fair value of the award, and is recognized as expense over the employee's requisite service period of the award. All of our stock compensation is accounted for as an equity instrument.

The following table summarizes compensation costs related to our stock-based awards (in thousands, except per share data):

	Three Months Ended March 31, 2015	2014
Cost of revenue	$5	$5
Selling, general and administrative	225	244
Research and development	44	43
Total stock-based compensation	274	292
Tax effect on stock-based compensation	—	—
Net effect on net income (loss)	$274	$292

As of March 31, 2015, the unamortized compensation costs related to unvested stock options granted to employees under our stock option plans were approximately $1.4 million, net of estimated forfeitures of $54,000. These costs are amortized on a straight-line basis over a weighted-average period of approximately 2.7 years and will be adjusted for subsequent changes in estimated forfeitures. We elected not to capitalize any stock-based compensation to inventory as of March 31, 2015 due to the immateriality of the amount.

We estimate the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of ASC 718. There were no stock options granted in the three months ended March 31, 2015 and 2014.

The following table summarizes our stock option activities during the three months ended March 31, 2015 (in thousands, except per share data):

Stock Options	Shares	Weighted-average Exercise Price	Weighted-average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Balance as of January 1, 2015	3,198	$ 3.12	6.95	$ 1,247
Granted	—	—		
Exercised	(54)	1.40		
Canceled and expired	(29)	2.74		
Balance as of March 31, 2015	3,115	$ 3.16	6.72	$ 966
Options vested and expected to vest as of March 31, 2015	3,115	$ 3.16	6.72	$ 966
Options exercisable as of March 31, 2015	1,885	$ 3.51	5.35	$ 667

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing price of $2.69 on March 31, 2015, which would have been received by the option holder had all option holders exercised their options on that date.

Restricted stock awards

A summary of activity related to restricted stock awards for the three months ended March 31, 2015 is presented below (in thousands, except per share data):

Stock Awards	Shares	Weighted-Average Grant Date Fair Value	
Non-vested as of January 1, 2015	261	$	2.71
Granted	—	$	—
Vested	—	$	—
Non-vested as of March 31, 2015	261	$	2.71

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As of March 31, 2015, the unamortized compensation costs related to unvested restricted stock awards was approximately $511,000, which is to be amortized on a straight-line basis over a weighted-average period of approximately 2.2 years.

Note 9. Net Income (loss) Per Share

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

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

	Three Months Ended March 31,	
	2015	2014
Numerator:		
Net loss attributable to AXT, Inc.	$(1,024)	$(2,040)
Less: Preferred stock dividends	(44)	(44)
Net loss available to common stockholders	$(1,068)	$(2,084)
Denominator:		
Denominator for basic net loss per share - weighted average common shares	32,553	32,364
Effect of dilutive securities:		
Common stock options	—	—
Restricted stock awards	—	—
Denominator for dilutive net loss per common share	32,553	32,364
Net loss attributable to AXT, Inc. per common share:		
Basic	$(0.03)	$(0.06)
Diluted	$(0.03)	$(0.06)
Weighted-average shares:		
Options excluded from diluted net loss per share as the impact is anti-dilutive	3,167	2,607
Restricted stock excluded from diluted net loss per share as the impact is anti-dilutive	261	241

The 883,000 shares of $0.001 par value Series A preferred stock issued and outstanding as of March 31, 2015 and December 31, 2014, valued at $3,532,000, are non-voting and non-convertible preferred stock with a 5.0% cumulative annual dividend rate payable when declared by the board of directors and a $4 per share liquidation preference over common stock, which must be paid before any distribution is made to common stockholders. These preferred shares were issued to Lyte Optronics, Inc. stockholders in connection with the completion of our acquisition of Lyte Optronics, Inc. on May 28, 1999.

Note 10. Segment Information and Foreign Operations

Segment Information

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

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

	Three Months Ended March 31, 2015	2014
Geographical information:		
Europe (primarily Germany)	$4,943	$6,583
China	3,297	4,165
Asia Pacific (excluding China, Japan and Taiwan)	2,759	2,389
Taiwan	3,109	2,115
Japan	2,484	2,313
North America (primarily the United States)	3,472	1,780
Total	$20,064	$19,345

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

	As of March 31, 2015	December 31, 2014
Long-lived assets by geographic region:		
United States of America	$403	$ 136
China	32,820	33,726
	$33,223	$ 33,862

Significant Customers

No customer represented more than 10% of our revenue for the three months ended March 31, 2015 and 2014. Our top five customers, although not the same five customers for each period, represented 35% and 39% of our revenue for the three months ended March 31, 2015 and 2014, respectively.

We perform ongoing credit evaluations of our customers' financial condition, and limit the amount of credit extended when deemed necessary, but generally do not require collateral. No customer accounted for over 10% of our accounts receivable balance as of March 31, 2015 while two customers accounted for 11% and 10% of our accounts receivable balance as of December 31, 2014.

Note 11. Commitments and Contingencies

Indemnification Agreements

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

Product Warranty

We provide warranties for our products for a specific period of time, generally twelve months, against material defects. We provide for the estimated future costs of warranty obligations in cost of sales when the related revenue is recognized. The accrued warranty costs represent the best estimate at the time of sale of the total costs that we expect to incur to repair or replace product parts that fail while still under warranty. The amount of accrued estimated warranty costs are primarily based on historical experience as to product failures as well as current information on repair costs. On a quarterly basis, we review the accrued balances and update the historical warranty cost trends. The following table reflects the change in our warranty accrual which is included in “accrued liabilities” on the condensed consolidated balance sheets, during the three months ended March 31, 2015 and 2014 (in thousands):

	Three Months Ended March 31,	
	2015	2014
Beginning accrued warranty and related costs	$802	$1,048
Accruals for warranties issued	174	496
Adjustments related to pre-existing warranties including expirations and changes in estimates	(294)	(103)
Cost of warranty repair	(290)	(214)
Ending accrued warranty and related costs	$392	$1,227

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Contractual Obligations

We lease certain office space, warehouse facilities and equipment under long-term operating leases expiring at various dates through December 2025. The majority of our lease obligations relates to our lease agreement for the facility in Fremont, California with approximately 19,467 square feet.

We entered into a royalty agreement with a competitor effective December 3, 2010 with a term of eight years, terminating December 31, 2018. We and our related companies are granted a worldwide, nonexclusive, royalty bearing, irrevocable license to certain patents for the term on the agreement. We shall pay a total of $7.0 million royalty payment over eight years that began in 2011 based on future royalty bearing sales. This agreement contains a clause that allows us to claim for credit, starting in 2013, in the event that the royalty bearing sales for the year is lower than a pre-determined amount set forth in this agreement.

Outstanding contractual obligations as of March 31, 2015 are summarized as follows (in thousands):

	Payments due by period				
Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Operating leases	$690	$236	$289	$54	$111
Royalty agreement	2,325	744	1,150	431	—
Total	$3,015	$980	$1,439	$485	$111

Purchase Obligations with Penalties for Cancellation

In the normal course of business, we issue purchase orders to various suppliers. In certain cases, we may incur a penalty if we cancel the purchase order. As of March 31, 2015, we do not have any outstanding purchase orders that will incur a penalty if cancelled by the Company.

Legal Proceedings

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

Note 12. Foreign Exchange Transaction Gains/Losses

We incurred foreign currency transaction exchange gains of $180,000 and $17,000 for the three months ended March 31, 2015 and 2014, respectively. These amounts are included in “Other income, net” on our condensed consolidated statements of operations.

Note 13. Income Taxes

We account for income taxes in accordance with ASC topic 740, Income Taxes (“ASC 740”) which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized.

In accordance with Section 382 of the Internal Revenue Code, the amounts of and benefits from net operating loss and tax credit carryforwards may be impaired or limited in certain circumstances. Events which cause limitations in the amount of net operating losses or credits that we may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50% as defined, over a three year period. As a result of the implementation of Interpretation 48, we recognized $16.4 million of liability for unrecognized tax benefits. Of this amount, none was accounted for as a reduction to balance of retained earnings. The amount decreased tax loss carryforwards in the U.S., which are fully offset by a valuation allowance.

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We recognize interest and penalties related to uncertain tax positions in income tax expense. Income tax expense for the three month ended March 31, 2015 includes no interest and penalties. As of March 31, 2015, we have no accrued interest and penalties related to uncertain tax positions. We file income tax returns in the U.S. federal, various states and foreign jurisdictions. We have substantially concluded all U.S. federal and state income tax matters through December 31, 2013.

Provision for income taxes for three months ended March 31, 2015 and 2014 was mostly related to our China subsidiaries and our China joint venture operations. We have made a tax election in China whereby certain minimum foreign withholding taxes are treated as an expense and not a tax credit. Besides the state taxes liabilities, no federal income tax benefit or expense has been provided for the three months ended March 31, 2015 or 2014 due to our net loss, our valuation allowance being utilized and uncertainty of future profits in the U.S.

Note 14. Restructuring Charges

On February 25, 2014, we announced a restructuring plan with respect to our wholly-owned subsidiary, Beijing Tongmei Xtal Technology Co, Ltd. (“Tongmei”) in order to better align manufacturing capacity with demand. Under the restructuring plan, Tongmei implemented certain workforce reductions with respect to its manufacturing facility in China. We also announced that the restructuring plan would be completed by March 31, 2014, depending on local legal requirements.

In the first quarter of 2014, we reduced the workforce at Tongmei by approximately 93 positions that were no longer required to support production and operations, or approximately 11 percent of the workforce. Accordingly, we recorded a restructuring charge of approximately $907,000 related to the reduction in force for severance-related expenses. As of March 31, 2014, we completed this restructuring plan and the reduction in force. We had no restructuring charge in the first three months of 2015.

Note 15. Whistleblower Complaint and Investigation

On February 23, 2015, the Board of Directors announced that, pursuant to an anonymous whistleblower complaint, our Audit Committee has conducted an investigation of certain potential related-party transactions involving Davis Zhang, our President, China Operations. The investigation did not conclude that there was any intentional misconduct by Mr. Zhang, or that he received any improper benefit from these transactions. Further, the investigation did not reveal any inaccuracies in our financial statements resulting from these transactions. However, the investigation identified certain historical related-party transactions that were not previously disclosed in our filings with the Securities and Exchange Commission (“SEC”). We have filed a Current Report on Form 8-K with the SEC on February 23, 2015 to disclose such historical related-party transactions.

On February 20, 2015, the Board waived any potential inconsistencies with our Code of Conduct and Ethics arising from the transactions identified in the investigation. Also, the Audit Committee approved the related-party nature of such transactions to the extent it had not previously approved such transactions. The Board and Audit Committee specified that such waiver and approval would have retroactive effect to the date of commencement of the transactions covered by such waiver and approval. We have incurred approximately $1.8 million of professional service fees during the course of this investigation.

Note 16. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued a new standard to achieve a consistent application of revenue recognition within the U.S., resulting in a single revenue model to be applied by reporting companies under U.S. generally accepted accounting principles. Under the new model, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard is effective for us beginning in the first quarter of 2018; early adoption is prohibited. The new standard is required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying it recognized at the date of initial application.

Note 17. Subsequent Events

Resignation of Davis Zhang

On April 17, 2015, Davis Zhang notified us of his decision to resign as our President, China Operations. His resignation will be effective as of May 15, 2015.

Gallium arsenide materials were placed on a revised list of hazardous substances requiring a permit for use in manufacturing. We do not yet have that permit.

From time to time, the Chinese government issues new regulations, which may require additional actions on our part to comply. On February 27, 2015, the China State Administration of Work Safety updated its list of hazardous substances. The previous list, which was published in 2002, did not restrict the materials that we use in our wafers. The new list added gallium arsenide. As a result of the newly published list, we were required to obtain a permit by May 1, 2015 to continue to manufacture our gallium arsenide substrate wafers. We initiated discussions with the local district agency to obtain the requisite permit. On May 4, 2015, we were instructed by the local district agency that because we had not yet received the requisite permit, we should cease manufacturing our gallium arsenide substrate wafers or we should obtain permission to continue manufacturing our gallium arsenide substrate wafers from a municipal-level office, such as the Beijing municipal authority. The Beijing municipal authority accepted our application on May 7, 2015 and our application is under review. We expect to continue to manufacture gallium arsenide substrate wafers while going through the compliance examination process to receive the requisite permit. If we do not receive the requisite permit to continue to manufacture gallium arsenide substrate wafers, we may be required to cease manufacturing such wafers until we receive the requisite permit. A halt to our production of gallium arsenide substrate wafers could have a material adverse effect on our revenue and profits and could also result in our furloughing approximately several hundred manufacturing employees. See the section entitled “Risk Factors” for additional information about these risks and uncertainties.

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

This quarterly report on Form 10-Q, including the following sections, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, particularly statements relating to our expectations regarding results of operations, customer demand, our ability to expand our markets and increase sales, industry trends, customer qualifications of our products, gross margins, the impact of the adoption of certain accounting pronouncements, our investments in capital projects, our belief that we have adequate cash and investments to meet our needs over the next 12 months, and our ability to continue to manufacture gallium arsenide substrate wafers. These forward-looking statements are based upon management's current views with respect to future events and financial performance, and are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or those anticipated in such forward-looking statements. Such risks and uncertainties include those set forth under the section entitled "Risk Factors" below, which identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in this Form 10-Q and other filings we have made with the Securities and Exchange Commission. Forward-looking statements may be identified by the use of terms such as "anticipates," "believes," "estimates," "expects," "intends," and similar expressions. Statements concerning our future or expected financial results and condition, business strategy and plans or objectives for future operations are forward-looking statements.

These forward-looking statements are not guarantees of future performance. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to revise or update any forward looking statements in order to reflect any event or circumstance that may arise after the date of this report. Readers are urged to carefully review and consider the various disclosures made in this report, which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects. This discussion should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2014 and the condensed consolidated financial statements included elsewhere in this report.

Overview

AXT is a worldwide developer and producer of high-performance compound and single element semiconductor substrates, also known as wafers. The dominant substrates used in producing semiconductor chips are made from silicon. However, certain chips may become too hot or perform their function too slowly if silicon is used as the base material. Alternative or specialty materials are used to replace silicon as the preferred base for the electronic circuit in these situations. We provide such alternative or specialty materials in the form of substrates or wafers, including compound and single element substrates. Our compound substrates combine gallium with arsenic (GaAs) or combine indium with phosphorous (InP). Our single element substrates are made from germanium (Ge). Most of our revenue is from sales of GaAs substrates. We currently sell the following substrate products in the sizes and for the applications indicated:

Product Substrates	Diameter	Applications
GaAs (semi-insulating)	1", 2", 3", 4", 5", 6"	· Power amplifiers and radio frequency integrated circuits for wireless handsets (cell phones) · Direct broadcast television · High-performance transistors · Satellite communications
	1", 2", 3", 4", 6"	High brightness light emitting diodes

GaAs (semi-conducting)		· Lasers · Optical couplers
InP	2”, 3”, 4”	· Broadband and fiber optic communications
Ge	2”, 4”, 6”	· Satellite and terrestrial solar cells · Optical applications

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We manufacture all of our semiconductor substrates using our proprietary vertical gradient freeze (VGF) technology. We manufacture all of our products in the People's Republic of China (PRC or China), which generally has favorable costs for facilities and labor compared with comparable facilities in the United States, Europe or Japan. Our supply chain includes AXT subsidiaries and joint ventures in China. We believe this supply chain arrangement provides us pricing advantages, reliable supply and enhanced sourcing lead-times for key raw materials which are central to our final manufactured products. Our subsidiaries and joint ventures produce products including 99.99% pure gallium (4N Ga), high purity gallium, arsenic, germanium, germanium dioxide, pyrolytic boron nitride (pBN) crucibles and boron oxide (B2O3). Our ownership and the ownership by our consolidated subsidiaries in these entities range from 20% to 83%. We consolidate, for accounting purposes, the joint ventures in which we have majority or controlling financial interest and significant influence on management, and employ equity accounting for the joint ventures in which we have a smaller ownership interest. We purchase portions of the materials produced by these joint ventures for our own use and the joint ventures sell the remainder of their production to third parties. We use our direct sales force in the United States and China, and independent sales representatives in Europe and other parts of Asia to market and sell our substrates.

Critical Accounting Policies and Estimates

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

We have identified the policies below as critical to our business operations and understanding of our financial condition and results of operations. Critical accounting policies are material to the presentation of our consolidated financial statements and require us to make difficult, subjective or complex judgments that could have a material effect on our financial condition and results of operations. They may require us to make assumptions about matters that are highly uncertain at the time of the estimate. Different estimates that we could have used, or changes in the estimate that are reasonably likely to occur, may have a material impact on our financial condition or results of operations.

Revenue Recognition

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

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

Accounts Receivable and Allowance for Doubtful Accounts

We periodically review the likelihood of collection on our accounts receivable balances and provide an allowance for doubtful accounts receivable primarily based upon the age of these accounts. We evaluate receivables from U.S. customers with an emphasis on balances in excess of 90 days and for receivables from customers located outside the U.S. with an emphasis on balances in excess of 120 days and establish a reserve on the receivable balances if needed. The reason for the difference in the evaluation of receivables between foreign and U.S. customers is that U.S. customers have historically made payments in a shorter period of time than foreign customers. Foreign business practices generally require us to allow customer payment terms that are longer than those accepted in the United States. We assess the probability of collection based on a number of factors, including the length of time a receivable balance has been outstanding, our past history with the customer and their creditworthiness.

As of March 31, 2015 and December 31, 2014, our accounts receivable, net, balance was $18.8 million and $17.9 million, respectively, which was net of an allowance for doubtful accounts of $560,000 and $410,000, respectively. If actual uncollectible accounts differ substantially from our estimates, revisions to the estimated allowance for doubtful accounts would be required, which could have a material impact on our financial results for the future periods.

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The allowance for sales returns is also deducted from gross accounts receivable. As of March 31, 2015 and December 31, 2014, our allowance for sales returns was $489,000 and $413,000, respectively.

Warranty Reserve

We maintain a warranty reserve based upon our claims experience during the prior twelve months. Warranty costs are accrued at the time revenue is recognized. As of March 31, 2015 and December 31, 2014, accrued product warranties totaled $392,000 and $802,000, respectively. The decrease in accrued product warranties is primarily attributable to decreased claims for quality issues experienced by some customers. If actual warranty costs differ substantially from our estimates, revisions to the estimated warranty liability would be required, which could have a material impact on our financial condition and results of operations for future periods.

Inventory Valuation

Inventories are stated at the lower of cost or market. Cost is determined using the weighted-average cost method. Our inventory consists of raw materials as well as finished goods and work-in-process that include material, labor and manufacturing overhead costs. Given the nature of our substrate products, and the materials used in the manufacturing process, the wafers and ingots comprising work-in-process may be held in inventory for up to two years and three years, respectively, as the risk of obsolescence for these materials is low. We routinely evaluate the levels of our inventory in light of current market conditions in order to identify excess and obsolete inventory, and we provide a valuation allowance for certain inventories based upon the age and quality of the product and the projections for sale of the completed products. As of March 31, 2015 and December 31, 2014, we had an inventory reserve of $11.4 million and $11.2 million, respectively, for excess and obsolete inventory. If actual demand for our products were to be substantially lower than estimated, additional inventory adjustments for excess or obsolete inventory might be required, which could have a material impact on our business, financial condition and results of operations.

Impairment of Investments

We classify our investments in debt and equity securities as available-for-sale securities in accordance with ASC topic 320, Investments - Debt and Equity Securities (“ASC 320”). All available-for-sale securities with a quoted market value below cost (or adjusted cost) are reviewed in order to determine whether the decline is other-than-temporary. Factors considered in determining whether a loss is temporary include the magnitude of the decline in market value, the length of time the market value has been below cost (or adjusted cost), credit quality, and our ability and intent to hold the securities for a period of time sufficient to allow for any anticipated recovery in market value.

We invest in equity instruments of privately-held companies in China for business and strategic purposes. These investments are classified as other assets and are accounted for under the cost method as we do not have the ability to exercise significant influence over their operations. We monitor our investments for impairment and record reductions in carrying value when events or changes in circumstances indicate that the carrying value may not be recoverable. Determination of impairment is highly subjective and is based on a number of factors, including an assessment of the strength of investee’s management, the length of time and extent to which the fair value has been less than our cost basis, the financial condition and near-term prospects of the investee, fundamental changes to the business prospects of the investee, share prices of subsequent offerings, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in our carrying value. We had no write downs for the three months ended March 31, 2015 or 2014.

Fair Value of Investments

ASC 820, Fair Value Measurement (“ASC 820”) establishes three levels of inputs that may be used to measure fair value.

Level 1 instruments represent quoted prices in active markets. Therefore, determining fair value for Level 1 instruments does not require significant management judgment, and the estimation is not difficult.

Level 2 instruments include observable inputs other than Level 1 prices, such as quoted prices for identical instruments in markets with insufficient volume or infrequent transactions (less active markets), issuer credit ratings, non-binding market consensus prices that can be corroborated with observable market data, model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities, or quoted prices for similar assets or liabilities. These Level 2 instruments require more management judgment and subjectivity compared to Level 1 instruments, including:

- Determining which instruments are most similar to the instrument being priced requires management to identify a sample of similar securities based on the coupon rates, maturity, issuer, credit rating, and instrument type, and subjectively select an individual security or multiple securities that are deemed most similar to the security being priced.

- Determining which model-derived valuations to use in determining fair value requires management judgment. When observable market prices for identical securities or similar securities are not available, we price our marketable debt instruments using non-binding market consensus prices that are corroborated with observable market data or pricing models, such as discounted cash flow models, with all significant inputs derived from or corroborated with observable market data.

Level 3 instruments include unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities. The determination of fair value for Level 3 instruments requires the most management judgment and subjectivity.

There have been no transfers between fair value measurement levels during the three months ended March 31, 2015.

Impairment of Long-Lived Assets

We evaluate the recoverability of property, equipment and intangible assets in accordance with ASC topic 360, Property, Plant and Equipment ("ASC 360"). When events and circumstances indicate that long-lived assets may be impaired, we compare the carrying value of the long-lived assets to the projection of future undiscounted cash flows attributable to these assets. In the event that the carrying value exceeds the future undiscounted cash flows, we record an impairment charge against income equal to the excess of the carrying value over the assets' fair value. Fair values are determined based on quoted market values, discounted cash flows or internal and external appraisals, as applicable. We had no "Assets held for sale" on the condensed consolidated balance sheet as of March 31, 2015 or December 31, 2014.

Stock-based Compensation

We account for stock-based compensation in accordance with ASC topic 718, Stock-based Compensation ("ASC 718"). Share-based awards granted include stock options and restricted stock awards. We utilize the Black-Scholes option pricing model to estimate the grant date fair value of stock options, which requires the input of highly subjective assumptions, including estimating stock price volatility and expected term. Historical volatility of our stock price was used while the expected term for our options was estimated based on historical option exercise behavior and post-vesting forfeitures of options, and the contractual term, the vesting period and the expected term of the outstanding options. Further, we apply an expected forfeiture rate in determining the amount of share-based compensation. We use historical forfeitures to estimate the rate of future forfeitures. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our stock compensation. The cost of restricted stock awards is determined using the fair value of our common stock on the date of grant.

We recognize the compensation costs net of an estimated forfeiture rate over the requisite service period of the options award, which is generally the vesting term of four years. Compensation expense for restricted stock awards is recognized over the vesting period, which is generally three years or four years. Stock-based compensation expense is recorded in cost of revenue, research and development, and selling, general and administrative expenses.

Income Taxes

We account for income taxes in accordance with ASC topic 740, Income Taxes ("ASC 740") which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized.

We provide for income taxes based upon the geographic composition of worldwide earnings and tax regulations governing each region, particularly China. The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws, particularly in foreign countries such as China.

See Note 13—"Income Taxes" in the notes to condensed financial statements for additional information.

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Results of Operations

Revenue

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Total revenue	$20,064	$19,345	$ 719	3.7 %

Revenue increased $719,000, or 3.7%, to $20.1 million for the three months ended March 31, 2015 from $19.3 million for the three months ended March 31, 2014. The revenue increase was primarily the result of a significant increase in InP revenue in the first quarter of 2015 as compared to the same period in the prior year. The InP revenue increase was the result of expanding applications in the marketplace, such as fiber optic lasers and data connectivity. In addition, our raw materials revenue increased as a result of stronger demand and our ability to respond quickly to short lead time requirements. The increase of revenue from InP and raw materials sales, however, was partially offset by the decreased demand for other substrate materials, particularly from our Ge substrates customers.

Revenue by Geographic Region

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Europe (primarily Germany)	$4,943	$6,583	$ (1,640)	(25)%
% of total revenue	25 %	34 %		
North America (primarily the United States)	3,472	1,780	1,692	95 %
% of total revenue	17 %	9 %		
China	3,297	4,165	(868)	(21)%
% of total revenue	16 %	22 %		
Taiwan	3,109	2,115	994	47 %
% of total revenue	16 %	11 %		
Asia Pacific (excluding China, Taiwan and Japan)	2,759	2,389	370	16 %
% of total revenue	14 %	12 %		
Japan	2,484	2,313	171	7 %
% of total revenue	12 %	12 %		
Total revenue	$20,064	$19,345	$ 719	4 %

Sales to customers located outside of North America represented approximately 83% and 91% of our revenue in the three months ended March 31, 2015 and 2014, respectively. Sales to customers in North America increased by $1.7 million, or 95%, mainly from the increase in InP sales in the first quarter of 2015 as compared to same period in 2014. Revenue by geographic region reflected strong expansion in North America and Asia partially offset by contraction in Europe.

Gross Margin

Three Months Ended March 31, Increase

	2015	2014	(Decrease)	% Change
	($ in thousands)			
Gross profit	$4,749	$2,718	$ 2,031	74.7 %
Gross Margin %	23.7 %	14.1 %		

Gross margin increased to 23.7% of total revenue in the three months ended March 31, 2015 from 14.1% of total revenue in the three months ended March 31, 2014. Gross margin increased primarily due to product mix and continuation of a company-wide cost-saving campaign which was first implemented in 2014.

Selling, General and Administrative Expenses

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Selling, general and administrative expenses	$5,251	$3,436	$ 1,815	52.8 %
% of total revenue	26.2 %	17.8 %		

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Selling, general and administrative expenses increased $1.8 million, or 52.8% to $5.3 million for the three months ended March 31, 2015 from $3.4 million for the three months ended March 31, 2014. The higher selling, general and administrative expenses resulted from an increase in professional services of $1.2 million related to an investigation of certain potential related-party transactions and higher personnel related costs. We expect our selling, general administrative expenses to decrease as the investigation has concluded and we do not anticipate additional professional services in the second quarter of 2015.

Research and Development

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Research and development	$1,241	$775	$ 466	60.1 %
% of total revenue	6.2 %	4.0 %		

Research and development expenses increased $466,000, or 60.1% to $1.2 million for the three months ended March 31, 2015 from $775,000 for the three months ended March 31, 2014. The increase was primarily due to higher product development and testing costs and personnel-related costs.

Restructuring Charges

In the first quarter of 2014, we reduced the workforce at Tongmei by approximately 93 positions that were no longer required to support production and operations, or approximately 11% of the workforce. Accordingly, we recorded a restructuring charge of approximately $907,000 related to the reduction in force for severance-related expenses. As of March 31, 2014, we completed this restructuring plan and the reduction in force. We had no restructuring charge in the first three months of 2015.

Interest Income, net

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Interest income, net	$97	$127	$ (30)	23.6 %
% of total revenue	0.5%	0.7 %		

Interest income, net decreased $30,000 to $97,000 for the three months ended March 31, 2015 from $127,000 for the three months ended March 31, 2014. The decrease was primarily due to lower returns from our mix of investment securities held.

Equity in Earnings of Unconsolidated Joint Ventures

	Three Months	Increase

	Ended March 31,			
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Equity in earnings of unconsolidated joint ventures	$200	$487	$ (287)	58.9 %
% of total revenue	1.0 %	2.5 %		

Equity in earnings of unconsolidated joint ventures is primarily net income from our minority-owned joint ventures that are not consolidated. Equity in earnings of unconsolidated joint ventures decreased $287,000 to $200,000 for the three months ended March 31, 2015 from $487,000 for the three months ended March 31, 2014 primarily due to lower net income from our minority-owned joint ventures that are not consolidated.

Other Income, net

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Other income, net	$633	$10	$ 623	6,230.0%
% of total revenue	3.2 %	0.1 %		

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Other income, net increased $623,000 to $633,000 for the three months ended March 31, 2015 from $10,000 for the three months ended March 31, 2014 primarily due to a gain of approximately $368,000 recognized from the sale of common stock of Intelligent Epitaxy Technology, Inc ("IntelliEpi"), a Taiwan publicly traded company, in the first quarter of 2015. In addition, we had a favorable gain of $180,000 in foreign currency exchange in the three months ended March 31, 2015 as compared to $17,000 in the three months ended March 31, 2014.

Provision for Income Taxes

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Provision for income taxes	$86	$59	$ 27	45.8 %
% of total revenue	0.4%	0.3 %		

Provision for income taxes for the three months ended March 31, 2015 was $86,000 , which was mostly related to our consolidated subsidiaries in China. The increase in provision for income taxes from the three months ended March 31, 2014 to the three months ended March 31, 2015 was primarily due to increased sales and net income of our foreign subsidiaries as well as higher taxable income for state tax purposes in the U.S. Besides the state tax liabilities, no income taxes or tax benefits have been provided for U.S. operations due to the loss in the U.S. and the uncertainty of generating future profit in the U.S. which has resulted in our deferred tax asset being fully reserved.

Noncontrolling interests

	Three Months Ended March 31,		Increase	
	2015	2014	(Decrease)	% Change
	($ in thousands)			
Noncontrolling interests	$125	$205	$ (80)	(39.0)%
% of total revenue	0.6 %	1.1 %		

Net income attributable to noncontrolling interests decreased $80,000, or 39.0% to $125,000 for the three months ended March 31, 2015 from $205,000 for the three months ended March 31, 2014 primarily due to lower profitability from our China joint venture operations as profits from raw materials sales have decreased due to decreased selling prices.

Liquidity and Capital Resources

We consider cash and cash equivalents, short-term investments and long-term investments as liquid and available for use within two years in our current operations. Short-term investments and long-term investments are comprised of U.S. government securities and investment-grade corporate notes and bonds. Also included in short-term investments is our investment in common stock of IntelliEpi. In 2013, we re-categorized our IntelliEpi investment from cost method to short-term investments as IntelliEpi completed its initial public offering in 2013.

As of March 31, 2015, our principal source of liquidity was $47.5 million, which consisted of cash and cash equivalents of $33.3 million, short-term investments of $3.6 million and long-term investments of $10.6 million. The increase in cash and cash equivalents of $4.5 million in the first quarter of 2015 was primarily due to net cash provided by investing activities of $5.3 million and the effect of exchange rate changes of $62,000, offset by net cash used in operating activities of $349,000 and net cash used in financing activities of $541,000. As of March 31, 2015, we and our consolidated joint ventures held approximately $18.9 million in cash and investments in foreign bank accounts. This consists of $11.1 million held by our wholly owned subsidiary in China and $7.8 million held by our three partially-owned consolidated subsidiaries in China. Of this $18.9 million, approximately $13.6 million would not be available for use in the United States without paying United States income taxes.

Net cash used by operating activities of $349,000 for the three months ended March 31, 2015 was primarily comprised of our net loss of $899,000, adjusted for non-cash items of depreciation of $1.4 million, stock-based compensation of $274,000, amortization of marketable securities premium of $55,000, provision for doubtful account of $150,000 and loss on disposal property and equipment of $9,000 offset by the realized gain on sales of investments of $367,000 and a net change of $1.0 million in assets and liabilities.

Net cash used by operating activities of $387,000 for the three months ended March 31, 2014 was primarily comprised of our net loss of $1.8 million, adjusted for non-cash items of depreciation of $1.4 million, stock-based compensation of $292,000, amortization of marketable securities premium of $122,000, offset by gain on disposal property and equipment of $5,000, and a net change of $366,000 in assets and liabilities.

Net cash provided by investing activities of $5.3 million for the three months ended March 31, 2015 was primarily from the proceeds from maturities and sales of available-for-sales securities of $10.3 million, partially offset by net purchases of marketable investment securities of $4.3 million and the purchase of property, plant and equipment of $676,000.

Net cash used in investing activities of $1.7 million for the three months ended March 31, 2014 was primarily from the net purchases of marketable investment securities of $3.7 million, the purchase of property, plant and equipment of $163,000, partially offset by the proceeds from the sales of available-for-sales securities of $2.2 million and proceeds from sales of property, plant and equipment of $5,000.

Net cash used in financing activities was $541,000 for the three months ended March 31, 2015, which consisted of $617,000 for the repurchase of the Company's common stock, including commission and fees, partially offset by net proceeds of $76,000 on the issuance of common stock pursuant to stock option exercises.

There was no cash used in or provided by financing activities for the three months ended March 31, 2014.

On February 21, 2013, our Board of Directors approved a stock repurchase program pursuant to which we may repurchase up to $6.0 million of our outstanding common stock through February 27, 2014. These purchases could be made from time to time in the open market and are funded from our existing cash balances and cash generated from operations. During 2013, we repurchased approximately 285,000 shares at an average price of $2.51 per share for a total purchase price of $716,000 under the stock repurchase program. As of December 31, 2013, approximately $5.3 million remained available for future repurchases under this program. No shares were repurchased in 2014 under this program and the plan expired on February 27, 2014.

On October 27, 2014, our Board of Directors approved a stock repurchase program pursuant to which we may repurchase up to $5.0 million of our outstanding common stock. These repurchases can be made from time to time in the open market and are funded from our existing cash balances and cash generated from operations. During the three months ended March 31, 2015, we repurchased approximately 230,000 shares at an average price of $2.67 per share for a total purchase price of $617,000 under the stock repurchase program. As of March 31, 2015, approximately $4.4 million remained available for future repurchases under this program. See Item 2, Unregistered Sales of Equity Securities and Use of Proceeds in Part II, Other Information, for additional information.

We believe that we have adequate cash and investments to meet our needs over the next 12 months. If our sales decrease, however, our ability to generate cash from operations will be adversely affected which could adversely affect our future liquidity, require us to use cash at a more rapid rate than expected, and require us to seek additional capital. There can be no assurance that such additional capital will be available or, if available it will be on terms acceptable to us.

Cash from operations could be affected by various risks and uncertainties, including, but not limited to those set forth below under Item 1A "Risks Factors."

Line of Credit

Prior to 2015, we had an unused credit facility with a bank that provided for a line of credit of $10.0 million. The line of credit was secured by marketable securities we had with the bank at that time. This line of credit was never used and there were no outstanding borrowings under this line of credit as of March 31, 2015 and December 31, 2014. This line of credit was terminated in January 2015 when we closed our investment account with this institution and moved all of our funds from this bank to a different bank.

Contractual Obligations and Operating Leases

We lease certain office space, warehouse facilities and equipment under long-term operating leases expiring at various dates through December 2025. The majority of our lease obligations relates to our lease agreement for the facility in Fremont, California with approximately 19,467 square feet.

We entered into a royalty agreement with a competitor effective December 3, 2010 with a term of eight years, terminating December 31, 2018. We and our related companies are granted a worldwide, nonexclusive, royalty bearing, irrevocable license to certain patents for the term on the agreement. We shall pay a total of $7.0 million royalty payment over eight years that began in 2011 based on future royalty bearing sales. This agreement contains a clause that allows us to claim for credit, starting in 2013, in the event that the royalty bearing sales for the year is lower than a pre-determined amount set forth in this agreement.

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Outstanding contractual obligations as of March 31, 2015 are summarized as follows (in thousands):

	Payments due by period				
Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Operating leases	$690	$236	$289	$54	$111
Royalty agreement	2,325	744	1,150	431	—
Total	$3,015	$980	$1,439	$485	$111

Purchase orders or contracts for the purchase of certain goods and services are not included in the preceding table. We cannot determine the aggregate amount of such purchase orders that represent contractual obligations because purchase orders may represent authorizations to purchase rather than binding agreements. For the purposes of this table, contractual obligations for purchase of goods or services are defined as agreements that are enforceable and legally binding and that specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction. Our purchase orders are based on our current needs and are fulfilled by our vendors within short time horizons. We also enter into contracts for outsourced services; however, the obligations under these contracts were not significant and the contracts generally contain clauses allowing for cancellation without significant penalty. Contractual obligations that are contingent upon the achievement of certain milestones are not included in the table above.

Off-Balance Sheet Arrangements

As of March 31, 2015, we did not have any off-balance sheet financing arrangements and have never established any special purpose entities as defined under SEC Regulation S-K Item 303(a)(4)(ii).

Recent Accounting Pronouncements

For a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our condensed consolidated financial statements, please see “Note 16 - Recent Accounting Pronouncements” in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

A significant portion of our business is conducted in currencies other than the U.S. dollar. Foreign exchange losses have had a material adverse effect on our operating results and cash flows in the past could have a material adverse effect on our operating results and cash flows in the future. If we do not effectively manage the risks associated with this currency risk, our revenue, cash flows and financial condition could be adversely affected. During 2014, we recorded net foreign exchange losses of $1.0 million, included as part of other income (expense), net in our consolidated statements of operations. In addition, we recorded unrealized foreign currency charges of $377,000 related to financial statement translations which are included in the balance of “accumulated other comprehensive income” on our consolidated balance sheets. We incurred foreign currency transaction exchange gains and losses due to operations in general. In the future we may experience foreign exchange losses on our non-functional currency denominated receivables and payables to the extent that we have not mitigated our exposure. Foreign exchange losses could have a materially adverse effect on our operating results and cash flows.

Our product sales to Japanese customers are typically invoiced in Japanese yen. As such we have foreign exchange exposure on our accounts receivable and on any Japanese yen denominated cash deposits. In 2014, the yen depreciated against the dollar. The major portion of our 2014 exchange loss is attributable to the yen's movement.

To partially protect us against fluctuations in foreign currency resulting from accounts receivable in Japanese yen from our Japanese customers, starting in 2015, we instituted a foreign currency hedging program. We place short term hedges that are intended to offset the potential cash exposure related to fluctuations in the exchange rate between the United States dollar and Japanese yen. We measure the fair value of these hedges at each month end and quarter end using current exchange rates and in accordance with generally accepted accounting principles. At quarter end any foreign currency hedges not settled are netted on the consolidated balance sheet and classified as Level 3 assets and liabilities. As of March 31, 2015 the net change in fair value from the placement of the hedge to settlement at each month end during the quarter had a de minimis impact to the consolidated results.

The functional currency for our foreign operations is the Renminbi, the local currency of China and in the future we may establish short term hedges covering Renminbi. Most of our operations are conducted in China, most of our costs are incurred in Chinese Renminbi, which subjects us to fluctuations in the exchange rates between the U.S. dollar and the Chinese Renminbi. We incur transaction gains or losses resulting from consolidation of expenses incurred in local currencies for our Chinese subsidiaries, including our joint ventures, as well as in translation of the assets and liabilities at each balance sheet date. Our financial results could be adversely affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets, including the revaluation by China of the Renminbi, and any future adjustments that China may make to its currency such as any move it might make to a managed float system with opportunistic interventions. We may also experience foreign exchange losses on our non-functional currency denominated receivables and payables.

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Although we currently are using a hedging program to minimize the effects of currency fluctuations relating to the Japanese yen and may apply this program to other currencies such as the Chinese Renminbi, our hedging position is partial, may not exist at all in the future and may not succeed in minimizing our foreign currency fluctuation risks. The Company's primary objective in holding these instruments is to reduce the volatility of earnings and cash flows associated with changes in foreign currency. The program is not designated for trading or speculative purposes.

Interest Rate Risk

Cash and cash equivalents earning interest and certain variable rate debt instruments are subject to interest rate fluctuations. The following table sets forth the probable impact of a 10% change in interest rates (in thousands):

Instrument	Balance as of March 31, 2015	Current Interest Rate	Projected Annual Interest Income/(Expense)	Proforma 10% Interest Rate Decline Income/(Expense)	Proforma 10% Interest Rate Increase Income/(Expense)
Cash and cash equivalent	$33,285	0.79 %	$ 263	$ 237	$ 289
Investment in debt and equity instruments	13,730	2.41 %	331	298	364
			$ 594	$ 535	$ 653

The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Financial instruments that potentially subject us to concentration of credit risk consist primarily of cash and cash equivalents, short-term investments, and trade accounts receivable. We invest primarily in money market accounts, certificates of deposits, corporate bonds and notes, and government securities. We are exposed to credit risks in the event of default by the issuers to the extent of the amount recorded on the consolidated balance sheets. These securities are generally classified as available-for-sale and consequently are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of estimated tax. Our cash, cash equivalents and short-term investments and long-term investments are in high-quality securities placed with major banks and financial institutions and commercial paper. We have no investments in auction rate securities.

Credit Risk

We perform ongoing credit evaluations of our customers' financial condition, and limit the amount of credit extended when deemed necessary, but generally do not require collateral. No customer accounted for over 10% of our trade accounts receivable balance as of March 31, 2015 while two customers accounted for 11% and 10% of our trade accounts receivable balance as of December 31, 2014.

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Equity Risk

We maintain minority investments directly, and indirectly through our consolidated joint ventures in privately-held companies located in China. These minority investments are reviewed for other than temporary declines in value on a quarterly basis. These investments are classified as other assets in the consolidated balance sheets and are either accounted for under the cost method or under the equity method as we do not have the ability to exercise significant influence over their operations. We monitor our investments for impairment and record reductions in carrying value when events or changes in circumstances indicate that the carrying value may not be recoverable. Reasons for other than temporary declines in value include whether the related company would have insufficient cash flow to operate for the next twelve months, significant changes in the operating performance and changes in market conditions. As of March 31, 2015 and December 31, 2014, the direct minority investments totaled $200,000, and the indirect minority investments by our consolidated joint ventures totaled $4.3 million and $4.0 million, respectively.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as such terms are defined under Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report in ensuring that information required to be disclosed on SEC reports is (i) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

No change in our internal control over financial reporting was made in the three months ended March 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

For ease of reference, we have divided these risks and uncertainties into the following general categories:

- Risks related to our general business;
- Risks related to international aspects of our business;
- Risks related to our financial results and capital structure;
- Risks related to our intellectual property; and
- Risks related to compliance and other legal matters.

Risks Related to Our General Business

Silicon substrates are significantly lower in cost compared to substrates made from specialty materials and new silicon-based technologies could allow silicon based substrates to replace specialty material based substrates for certain applications.

Historically silicon wafers or substrates are less expensive than specialty material substrates such as those that we produce. Electronic designers will generally consider silicon first and only turn to alternative materials if silicon cannot provide the required functionality in terms of power consumption, speed or other specifications. Beginning in 2011 certain applications that had previously used GaAs substrates adopted a new silicon-based technology called Silicon On Insulator, or SOI. SOI technology uses a silicon-insulator-silicon layered substrate in place of conventional silicon substrates in semiconductor manufacturing. SOI products cost less than GaAs substrates and although their performance is not as robust as GaAs substrates in terms of power consumption, heat generation and speed it is still acceptable in mobile phone and other applications that were previously dominated by GaAs substrates. The adoption of SOI has resulted in decreased GaAs wafer demand, and decreased revenue. If SOI or similar technologies gain more widespread market acceptance, or are used in more applications, our business and operating results could be significantly and adversely affected.

Underutilizing our manufacturing facilities may result in declines in our gross margins.

An important factor in our success is the extent to which we are able to utilize the available capacity in our manufacturing facilities. A number of factors and circumstances may reduce utilization rates, including periods of industry overcapacity, low levels of customer orders, operating inefficiencies, mechanical failures and disruption of operations due to expansion, power interruptions, fire, flood or other natural disasters or calamities. Because many portions of our manufacturing costs are relatively fixed, high utilization rates are critical to our gross margins and operating results. If we fail to achieve acceptable manufacturing volumes or experience product shipment delays, our results of operations will be negatively affected. During periods of decreased demand, we have underutilized our manufacturing lines. If we are unable to improve utilization levels at our facilities during periods of decreased demand

and correctly manage capacity, the fixed expense levels will have an adverse effect on our business, financial condition and results of operations. Our gross profit margins have fluctuated from period to period, and these fluctuations are expected to continue in the future. Within the last two years, our gross profit margin has fluctuated from 12.9% in the quarter ended June 30, 2013 to 25.4% in the quarter ended December 31, 2014 and for the quarter ended March 31, 2015 to 23.7%.

In 2013, we concluded that incoming orders were insufficient and that we were significantly underutilizing our factory capacity. As a result, in February 2014, we announced a restructuring plan with respect to our wholly-owned subsidiary, Beijing Tongmei Xtal Technology Co, Ltd., or Tongmei, in order to better align manufacturing capacity with demand. Under the restructuring plan, we posted a charge of approximately $907,000 in first quarter of 2014.

If we receive fewer customer orders than forecasted or if our customers delay or cancel orders, we may not be able to reduce our manufacturing costs in the short-term and our gross margins would be negatively affected. In addition, lead times required by our customers are shrinking which reduces our ability to forecast orders and properly balance our capacity utilization.

Our gross margin has fluctuated historically and may decline due to several factors.

Our gross product margin has fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices for products, utilization of our manufacturing capacity and our ability to reduce product costs. These fluctuations are expected to continue in the future.

We do not control the prices at which our subsidiaries and joint venture companies sell their raw materials products to third parties. However, as we consolidate the results of three of these companies with our own, any reduction in their gross margins could have a significant, adverse impact on our overall gross margins. One or more of our companies has in the past, and may in the future, sell raw materials at significantly reduced prices in order to gain volume sales or sales to new customers. In such an event, our gross margin may be adversely impacted. In addition, one of our consolidated subsidiaries has in the past been subject to capacity constraints requiring it to source product from other third party suppliers in order to meet customer demand, resulting in decreased gross margin and adversely impacting our gross margin. This joint venture may in the future continue to experience such capacity restraints, causing our gross margin, and consequently our operating results, to be adversely impacted.

Intense competition in the markets for our products could prevent us from increasing revenue and sustaining profitability.

The markets for our products are intensely competitive. We face competition for our substrate products from other manufacturers of substrates, such as Freiberger Compound Materials, JX, Umicore, Sumitomo Electric Industries and CCTC, from semiconductor device manufacturers that produce substrates for their own use, and from companies, such as TriQuint Semiconductors, RFMD and Skyworks that are actively developing alternative materials to GaAs and marketing semiconductor devices using these alternative materials. We believe that at least two of our major competitors are shipping high volumes of GaAs substrates manufactured using a technique similar to our VGF technology. Other competitors may develop and begin using similar technology. If we are unable to compete effectively, our revenue may not increase and we may be unable to remain profitable. We face many competitors that have a number of significant advantages over us, including:

- greater name recognition and market share in the business;
- more manufacturing experience;
- extensive intellectual property;
- significantly greater financial, technical and marketing resources.

Our competitors could develop new or enhanced products that are more effective than our products.

The level and intensity of competition has increased over the past years and we expect competition to continue to increase in the future. Competitive pressures have resulted in reductions in the prices of our products, and continued or increased competition could reduce our market share, require us to further reduce the prices of our products, affect our ability to recover costs and result in reduced gross margins.

In addition, new competitors have and may continue to emerge, such as a crystal growing company established by a former employee in China that is supplying semi-conducting GaAs wafers to the LED market. Competition from sources such as this could increase, particularly if these competitors are able to obtain large capital investments.

If we have low product yields, the shipment of our products may be delayed and our product cost and operating results may be adversely impacted.

A critical factor in our product cost is yield. Our products are manufactured using complex technologies, and the number of usable substrates we produce can fluctuate as a result of many factors, including:

- impurities in the materials used;

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- contamination of the manufacturing environment;
- quality control and inconsistency in quality levels;
- lack of automation and inconsistent processing resulting from manual manufacturing steps;
- substrate breakage during the manufacturing process;
- equipment failure, power outages or variations in the manufacturing process; and

In addition, we may modify our process to meet a customer specification but this can impact our yield. If our yields decrease, our revenue could decline if we are unable to produce product to our customers' requirements. At the same time, our manufacturing costs could remain fixed, or could increase. We have experienced product shipment delays and difficulties in achieving acceptable yields on both new and older products, and delays and poor yields have adversely affected our operating results. We may experience similar problems in the future and we cannot predict when they may occur or their duration or severity.

If our manufacturing processes result in defects in our products making them unfit for use by our customers, our products would be rejected, resulting in compensation costs paid to our customers, and possible disqualification. This could lead to revenue loss and market share loss.

Problems incurred by our subsidiaries and joint ventures or venture partners could result in a material adverse impact on our financial condition or results of operations.

We have invested in subsidiaries and joint venture operations in China that produce products including 99.99% pure gallium (4N Ga), high purity gallium, arsenic, germanium, germanium dioxide, pyrolytic boron nitride (pBN) crucibles and boron oxide (B2O3). We purchase a portion of the materials produced by these companies for our use and they sell the remainder of their production to third parties. Our ownership and the ownership held by our consolidated subsidiaries in these entities ranges from 20% to 83%. We consolidate the companies in which we have a majority or controlling financial interest and employ equity accounting for the joint ventures in which we have a smaller ownership interest. Several of these joint ventures occupy space within larger facilities owned and/or operated by one of the other venture partners. Several of these venture partners are engaged in other manufacturing activities at or near the same facility. In some facilities, we share access to certain functions, including water, hazardous waste treatment or air quality treatment. If any of our joint venture partners in any of these ventures experiences problems with its operations, disruptions of our joint venture operations could result, having a material adverse effect on the financial condition and results of operation of our joint ventures, and correspondingly on our financial condition or results of operations. For example, since gallium is a by-product of aluminum, our gallium joint venture in China, which is housed in and receives services from an affiliated aluminum plant, could generate lower production of gallium as a result of reduced by-product services provided by the aluminum plant. Accordingly, in order to meet customer supply obligations, our joint venture may have to source materials from another independent third party supplier, resulting in reduced gross margin.

In addition, if any of our joint ventures or venture partners with which our joint ventures share facilities is deemed to have violated applicable laws, rules or regulations governing the use, storage, discharge or disposal of hazardous chemicals during manufacturing, research and development or sales demonstrations, the operations of our joint ventures could be adversely affected and we could be subject to substantial liability for clean-up efforts, personal injury and fines or suspension or cessation of our joint venture operations as a result of the actions of the joint ventures or other venture partners. Employees working for our joint ventures or any of the other venture partners could bring litigation against us as a result of actions taken at the joint venture or venture partner facilities, even though we are not directly controlling the operations, including actions for exposure to chemicals or other hazardous materials at the facilities of our joint ventures or the facilities of any venture partner that are shared by our joint ventures. While we would expect to defend ourselves vigorously in any litigation that is brought against us, litigation is inherently uncertain and it is possible that our business, financial condition, results of operations or cash flows could be affected. Even if we are not deemed responsible for the actions of the joint ventures or venture partners, litigation could be costly, time consuming to defend and divert management attention; in addition, if we are deemed to be the most financially viable of the partners, plaintiffs may decide to pursue us for damages.

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Since all of our joint venture activity occurs in China, these activities could subject us to a number of risks associated with conducting operations internationally, including:

- difficulties in managing geographically disparate operations;
- difficulties in enforcing agreements through non-U.S. legal systems;
- unexpected changes in regulatory requirements that may limit our ability to export the venture products or sell into particular jurisdictions or impose multiple conflicting tax laws and regulations;
- political and economic instability, civil unrest or war;
- terrorist activities that impact international commerce;
- difficulties in protecting our intellectual property rights, particularly in countries where the laws and practices do not protect proprietary rights to as great an extent as do the laws and practices of the United States;
- changing laws and policies affecting economic liberalization, foreign investment, currency convertibility or exchange rates, taxation or employment; and
- nationalization of foreign owned assets, including intellectual property.

Demand for our products may decrease if demand for the end-user applications decrease or if manufacturers downstream in our supply chain experience difficulty manufacturing, marketing or selling their products.

Our products are used as components in electronic products. Accordingly, demand for our products is subject to the demand for end-user applications which utilize our products, as well as factors affecting the ability of the manufacturers downstream in our supply chain to introduce and market their products successfully, including:

- the competition such manufacturers face in their particular industries;
- the technical, manufacturing, sales and marketing and management capabilities of such manufacturers;
- the financial and other resources of such manufacturers; and
- the inability of such manufacturers to sell their products if they infringe third party intellectual property rights.

If demand for the end-user applications for which our products are used decreases, or if manufacturers downstream in our supply chain are unable to develop, market and sell their products, demand for our products will decrease.

The average selling prices of our products may decline over relatively short periods, which may reduce our gross margins.

The market for our products is characterized by declining average selling prices resulting from factors such as increased competition, overcapacity, the introduction of new products and decreased sales of products incorporating our products and as a result average selling prices for our products may decline over relatively short time periods. We have in the past experienced, and in the future may experience, substantial period-to-period fluctuations in operating results due to declining average selling prices. On average, for the year ended December 31, 2014 we experienced average selling price declines of approximately 5% to 10% depending on the product. It is possible that the pace of average selling price declines could accelerate beyond these levels for certain products in a commoditizing market. We anticipate that average selling prices will decrease in the future in response to the unstable demand environment, product introductions by competitors or us, or by other factors, including pricing pressures from significant customers. When our average selling prices decline, our gross profits decline unless we are able to sell more products or reduce the cost to manufacture our products. We generally attempt to combat average selling price declines by improving yields, manufacturing efficiency and working to reduce the costs of our raw materials and of manufacturing our products. We have in the past and may in the future experience declining sales prices, which could negatively impact our revenues, gross profits and financial results. We therefore need to sell our current products in increasing volumes to offset any decline in their average selling prices, and introduce new products, which we may not be able to do, or do on a timely basis.

We may be unable to reduce the cost of our products sufficiently to enable us to compete with others. Our cost reduction efforts may not allow us to keep pace with competitive pricing pressures and could adversely affect our margins. In order to remain competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes. We cannot assure you that any changes effected by us will result in sufficient cost reductions to allow us to reduce the price of our products to remain competitive or improve our gross margins.

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Defects in our products could diminish demand for our products.

Our products are complex and may contain defects, including defects resulting from impurities inherent in our raw materials or inconsistencies in our manufacturing processes. We have experienced quality control problems with some of our products, which caused customers to return products to us, reduce orders for our products, or both. We believe that we continue to experience certain reduction in orders as a result of product quality issues. If we continue to experience quality control problems, or experience these or other problems in new products, customers may cancel or reduce orders or purchase products from our competitors and we may be unable to maintain or increase sales to our customers and sales of our products could decline. Defects in our products could cause us to incur higher manufacturing costs and suffer product returns and additional service expenses, all of which could adversely impact our operating results.

If new products developed by us contain defects when released, our customers may be dissatisfied and we may suffer negative publicity or customer claims against us, lose sales or experience delays in market acceptance of our new products.

The Chinese government has imposed, and may impose in the future, manufacturing restrictions that could materially and adversely impact our results of operations and our financial condition.

The Chinese government has in the past imposed restrictions on manufacturing facilities, such as the restrictions imposed on polluting factories for the 2008 Olympics and the 2014 APEC event. These restrictions included a shut-down of the transportation of materials and power plants to reduce air pollution.

In addition, from time to time, the Chinese government issues new regulations, which may require additional actions on our part to comply. On February 27, 2015, the China State Administration of Work Safety updated its list of hazardous substances. The previous list, which was published in 2002, did not restrict the materials that we use in our wafers. The new list added gallium arsenide. As a result of the newly published list, we were required to obtain a permit by May 1, 2015 to continue to manufacture our gallium arsenide substrate wafers. We initiated discussions with the local district agency to obtain the requisite permit. On May 4, 2015, we were instructed by the local district agency that because we had not yet received the requisite permit, we should cease manufacturing our gallium arsenide substrate wafers or we should obtain permission to continue manufacturing our gallium arsenide substrate wafers from a municipal-level office, such as the Beijing municipal authority. The Beijing municipal authority accepted our application on May 7, 2015 and our application is under review. There can be assurances that we will receive the requisite permit from the Beijing municipal authority or from any other Chinese governmental authority. If we do not receive the requisite permit to continue to manufacture gallium arsenide substrate wafers, we may be required to cease manufacturing such wafers until we receive the requisite permit. A halt to our production of gallium arsenide substrate wafers could result in our furloughing approximately several hundred manufacturing employees. If we obtain the requisite permit after halting our production, we might not be able to recommence manufacturing gallium arsenide substrate wafers immediately because we may need to rebuild our chain and we may not be able to rehire our furloughed manufacturing employees. We could also lose customers to our competitors because of our inability to supply gallium arsenide substrate wafers. Any of these could materially and adversely impact our results of operations and our financial condition.

If, in the future, restrictions are imposed that affect our operations, our ability to supply current or new orders would be significantly impacted. Customers could then be required to purchase products from our competitors, causing our competitors to take market share from us. Restrictions on transportation of materials could limit our ability to transport our raw materials or products, and could result in bottlenecks at shipping ports, limiting our ability to deliver products to our customers. During periods of such restrictions, we may increase our stock of critical materials (such as arsenic, gallium, and other chemicals) for use during the period that these restrictions are likely to last, which will increase our use of cash and increase our inventory level, such as occurred during 2008. Any of these restrictions could materially and adversely impact our results of operations and our financial condition.

To reduce pollution in Beijing, the Chinese government has sometimes limited the addition or expansion of facilities by manufacturing companies in the Beijing area. If the government applied restrictions on us it could have an adverse impact on our results of operations and our financial condition.

The loss of one or more of our key substrate customers would significantly hurt our operating results.

Although no customer represented more than 10% of our revenue for the years ended March 31, 2015, we expect that a significant portion of our future revenue will continue to be derived from a limited number of substrate customers. Most of our customers are not obligated to purchase a specified quantity of our products or to provide us with binding forecasts of product purchases. In addition, our customers may reduce, delay or cancel orders at any time without any significant penalty. In the past, we have experienced slower bookings, significant push-outs and cancellation of orders from customers. If we lose a major customer or if a customer cancels, reduces or delays orders, or reduces the prices paid for our products, our revenue would decline. In addition, customers that have accounted for significant revenue in the past may not continue to generate revenue for us in any future period. Any delay in scheduled shipments of our products could cause revenue to fall below our expectations and the expectations of market analysts or investors, causing our stock price to decline.

The cyclical nature of the semiconductor industry may limit our ability to maintain or increase net sales and operating results during industry downturns.

The semiconductor industry is highly cyclical and periodically experiences significant economic downturns characterized by diminished product demand, resulting in production overcapacity and excess inventory in the markets we serve. A downturn can result in lower unit volumes and rapid erosion of average selling prices. The semiconductor industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product cycles of both semiconductor companies' and their customers' products or a decline in general economic conditions. This may adversely affect our results of operations and the value of our business.

Our continuing business depends in significant part upon manufacturers of electronic and opto-electronic compound semiconductor devices, as well as the current and anticipated market demand for these devices and products using these devices. As a supplier to the compound semiconductor industry, we are subject to the business cycles that characterize the industry. The timing, length and volatility of these cycles are difficult to predict. The compound semiconductor industry has historically been cyclical due to sudden changes in demand, the amount of manufacturing capacity and changes in the technology employed in compound semiconductors. The rate of changes in demand, including end demand, is high, and the effect of these changes upon us occurs quickly, exacerbating the volatility of these cycles. These changes have affected the timing and amounts of customers' purchases and investments in new technology. These industry cycles create pressure on our revenue, gross margin and net income.

Our industry has in the past experienced periods of oversupply and that has resulted in significantly reduced prices for compound semiconductor devices and components, including our products, both as a result of general economic changes and overcapacity. When this occurs our operating results and financial condition are adversely affected. Oversupply causes greater price competition and can cause our revenue, gross margins and net income to decline. During periods of weak demand, customers typically reduce purchases, delay delivery of products and/or cancel orders of component parts such as our products. Further order cancellations, reductions in order size or delays in orders could occur and would materially adversely affect our business and results of operations. Actions to reduce our costs may be insufficient to align our structure with prevailing business conditions. We may be required to undertake additional cost-cutting measures, and may be unable to invest in marketing, research and development and engineering at the levels we believe are necessary to maintain our competitive position. Our failure to make these investments could seriously harm our business.

We base our planned operating expenses in part on our expectations of future revenue, and a significant portion of our expense is relatively fixed. If revenue for a particular quarter is lower than we expect, we likely will be unable to proportionately reduce our operating expenses for that quarter, which would harm our operating results. For example, in 2013, we experienced significantly declining gross margins due to the allocation of fixed costs across a lower volume of sales than anticipated.

We purchase critical raw materials and parts for our equipment from single or limited sources, and could lose sales if these sources fail to fill our needs.

We depend on a limited number of suppliers for certain raw materials, components and equipment used in manufacturing our products, including key materials such as quartz tubing from our vendor, Kaide, and polishing solutions. Although several of these raw materials are purchased from suppliers in which we hold an ownership interest, we generally purchase these materials through standard purchase orders and not pursuant to long-term supply contracts, and no supplier guarantees supply of raw materials or equipment to us. If we lose any of our key suppliers, our manufacturing efforts could be significantly hampered and we could be prevented from timely producing and delivering products to our customers. Prior to investing in our subsidiaries and joint ventures, we sometimes experienced delays obtaining critical raw materials and spare parts, including gallium, due to shortages of these materials and we could experience such delays again in the future due to shortages of materials and may be unable to obtain an adequate supply of materials. These shortages and delays could result in higher materials costs and cause us to delay or reduce production of our products. If we have to delay or reduce production, we could fail to meet customer delivery schedules and our revenue and operating results could suffer.

If we do not successfully develop new products to respond to rapidly changing customer requirements, our ability to generate revenue, obtain new customers, and retain existing customers may suffer.

Our success depends on our ability to offer new products and product features that incorporate leading technology and respond to technological advances. In addition, our new products must meet customer needs and compete effectively on quality, price and performance. The life cycles of our products are difficult to predict. The markets for our products are characterized by rapid technological change, changing customer needs and evolving industry standards. If our competitors introduce products employing new technologies or performance characteristics, our existing products could become obsolete and unmarketable. During the past few years, we have seen our competitors selling more substrates manufactured using a crystal growth technology similar to ours, which has eroded our technological differentiation.

The development of new products can be a highly complex process, and we may experience delays in developing and introducing new products. Any significant delay could cause us to fail to timely introduce and gain market acceptance of new products. Further, the costs involved in researching, developing and engineering new products could be greater than anticipated. If we fail to offer new products or product enhancements or fail to achieve higher quality products, we may not generate sufficient revenue to offset our development costs and other expenses or meet our customers' requirements.

Our substrate products have a long qualification cycle that makes it difficult to plan our expenses and forecast our results.

New customers typically place orders with us for our substrate products three months to a year or more after our initial contact with them. The sale of our products may be subject to delays due to our customers' lengthy internal approval and evaluation processes. During this time, we may incur substantial expenses and expend sales, marketing and management efforts while the customers evaluate our products. These expenditures may not result in sales of our products. If we do not achieve anticipated sales in a period as expected, we may experience an unplanned shortfall in our revenue. As a result, we may not be able to cover expenses, causing our operating results to be adversely effected. In addition, if we fail to meet the product qualification requirements of the customer, we may not have another opportunity to sell products to this customer for many months or even years. In the current competitive climate, the average qualification and sales cycle for our products has lengthened even further and is expected to continue to make it difficult for us to forecast our future sales accurately. We anticipate that sales of any future substrate products will also have lengthy sales cycles and will, therefore, be subject to risks substantially similar to those inherent in the lengthy sales cycles of our current substrate products.

If any of our facilities are damaged by occurrences such as fire, explosion or natural disaster, we might not be able to manufacture our products.

The ongoing operation of our manufacturing and production facilities in China is critical to our ability to meet demand for our products. If we are not able to use all or a significant portion of our facilities for prolonged periods for any reason, we would not be able to manufacture products for our customers. For example, a fire or explosion caused by our use of combustible chemicals and high temperatures during our manufacturing processes or power interruption caused by severe weather conditions could render some or all of our facilities inoperable for an indefinite period of time. Actions outside of our control, such as earthquakes or other natural disasters, could also damage our facilities, rendering them inoperable. If we are unable to operate our facilities and manufacture our products, we would lose customers and revenue and our business would be harmed.

The financial condition of our customers may affect their ability to pay amounts owed to us.

Many of our customers are undercapitalized and cope with cash flow issues. We frequently allow our customers extended payment terms after shipping products to them. Subsequent to our shipping a product, some customers have been unable to make payments when due, reducing our cash balances and causing us to incur charges to allow for a possibility that some accounts might not be paid. Customers may also be forced to file for bankruptcy. If our customers do not pay their accounts we will be required to incur charges that would reduce our earnings.

We have made and may continue to make strategic investments in raw materials suppliers, which may not be successful and may result in the loss of all or part of our investment.

We have made investments through our subsidiaries and joint ventures in raw material suppliers in China, which provide us with opportunities to gain supplies of key raw materials that are important to our substrate business. These affiliates each have a market beyond that provided by us. We do not have influence over all of these companies and in some we have made only a strategic, minority investment. We may not be successful in achieving the financial, technological or commercial advantage upon which any given investment is premised, and we could end up losing all or part of our investment.

We depend on the continuing efforts of our senior management team and other key personnel. If we lose members of our senior management team or other key personnel, or are unable to successfully, recruit and train qualified personnel, our ability to manufacture and sell our products could be harmed.

Our future success depends on the continuing services of members of our senior management team and other key personnel. Our industry is characterized by high demand and intense competition for talent, and the turnover rate can be high. We compete for qualified management and other personnel with other semiconductor companies. Our employees could leave our company with little or no prior notice and would be free to work for a competitor. If one or more of our senior executives or other key personnel were unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all, and other senior management may be required to divert attention from other aspects of the business. The loss of any of these individuals or our ability to attract or retain qualified personnel could adversely affect our business.

Our results of operations may suffer if we do not effectively manage our inventory.

We must manage our inventory of raw materials, work-in-process and finished goods effectively to meet changing customer requirements, while keeping inventory costs down and improving gross margins. Although we seek to maintain sufficient inventory levels of certain materials to guard against interruptions in supply and to meet our near term needs, and have to date been able to obtain sufficient supplies of materials in a timely manner, in the future, we may experience shortages of certain key materials. Some of our products and supplies have in the past and may in the future become obsolete while in inventory due to changing customer specifications, or become excess inventory due to decreased demand for our products and an inability to sell the inventory within a foreseeable period. Furthermore, if market prices drop below the prices at which we value inventory, we may need to take a charge for a reduction in inventory values. We have in the past had to take inventory valuation and impairment charges. Any future unexpected changes in demand or increases in costs of production that cause us to take additional charges for un-saleable, obsolete or excess inventory, or to reduce inventory values, could adversely affect our results of operations.

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Financial market volatility and adverse changes in the domestic and global economic environment could have a significant adverse impact on our business, financial condition and operating results.

We are subject to the risks arising from adverse changes and uncertainty in domestic and global economies. Uncertain global economic conditions and low or negative growth in China, Europe and the United States, along with volatility in the financial markets, increasing national debt and fiscal concerns in various regions, pose challenges to our industry. Although we remain well-capitalized, the cost and availability of funds may be adversely affected by illiquid credit markets. Turbulence in U.S. and international markets and economies may adversely affect our liquidity, financial condition and profitability. Another severe or prolonged economic downturn could result in a variety of risks to our business, including:

- increased volatility in our stock price;
- increased volatility in foreign currency exchange rates;
- delays in, or curtailment of, purchasing decisions by our customers or potential customers either as a result of overall economic uncertainty or as a result of their inability to access the liquidity necessary to engage in purchasing initiatives;
- increased credit risk associated with our customers or potential customers, particularly those that may operate in industries most affected by the economic downturn; and
- impairment of our intangible or other assets.

In the recent past we experienced delays in customer purchasing decisions and disruptions in normal volume of customer orders that we believe were in part due to the uncertainties in the global economy and an adverse impact on consumer spending. During challenging and uncertain economic times and in tight credit markets, many customers delay or reduce technology purchases. Should similar events occur again, our business and operating results could be significantly and adversely affected.

Global economic conditions may have an impact on our business and financial condition in ways that we currently cannot predict.

Our operations and financial results depend on worldwide economic conditions and their impact on levels of business spending, which had deteriorated significantly in many countries and regions in previous years. Uncertainties in the financial and credit markets may cause our customers to postpone deliveries of ordered systems and placement of new orders and extended uncertainties may reduce future sales of our products and services. The revenue growth and profitability of our business depends on the overall demand for our substrates, and we are particularly dependent on the market conditions for the wireless, solid state illumination, fiber optics and telecommunications industries. Because the end users of our products are primarily large companies whose businesses fluctuate with general economic and business conditions, a softening of demand for products that use our substrates, caused by a weakening economy, may result in decreased revenue. Customers may find themselves facing excess inventory from earlier purchases, and may defer or reconsider purchasing products due to the downturn in their business and in the general economy. If market conditions deteriorate, we may experience increased collection times and greater write-offs, either of which could have a material adverse effect on our profitability and our cash flow.

Future tightening of credit markets and concerns regarding the availability of credit may make it more difficult for our customers to raise capital, whether debt or equity, to finance their purchases of capital equipment or of the products we sell. Delays in our customers’ ability to obtain such financing, or the unavailability of such financing, would adversely affect our product sales and revenues and therefore harm our business and operating results. We cannot predict the timing, duration of or effect on our business of any future economic downturn or the timing or strength of any subsequent recovery.

We may not be able to identify additional complementary joint ventures.

We believe that continuing to invest in additional joint ventures will be important to remaining competitive in our marketplace and ensuring a supply of critical raw materials. However, we may not be able to identify additional complementary joint venture opportunities or, even once opportunities are identified, we may not be able to reach agreement on the terms of the venture with the other venture partners. Additional joint ventures could cause us to incur contingent liabilities or other expenses, any of which could adversely affect our financial condition and operating results.

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The effect of terrorist threats and actions on the general economy could decrease our revenue.

Developed countries such as the United States and China continue to be on alert for terrorist activity. The potential near- and long-term impact terrorist activities may have in regards to our suppliers, customers and markets for our products and the economy is uncertain. There may be embargos of ports or products, or destruction of shipments or our facilities, or attacks that affect our personnel. There may be other potentially adverse effects on our operating results due to significant events that we cannot foresee. Since we perform all of our manufacturing operations in China, terrorist activity or threats against U.S. owned enterprises are a particular concern to us.

Risks Related to International Aspects of Our Business

We derive a significant portion of our revenue from international sales, and our ability to sustain and increase our international sales involves significant risks.

Our revenue growth depends in part on the expansion of our international sales and operations. International sales represented 88% of our revenue in 2014 and 2013 and 83% of our revenue in 2012. We expect that sales to customers outside the United States, particularly sales to customers in Japan, Taiwan and China, will continue to represent a significant portion of our revenue.

Currently, a significant percentage of our revenue is to customers headquartered in Asia. All of our manufacturing facilities and most of our suppliers are also located outside the United States. Managing our overseas operations presents challenges, including periodic regional economic downturns, trade balance issues, varying business conditions and demands, political instability, variations in enforcement of intellectual property and contract rights in different jurisdictions, differences in the ability to develop relationships with suppliers and other local businesses, changes in U.S. and international laws and regulations including U.S. export restrictions, fluctuations in interest and currency exchange rates, the ability to provide sufficient levels of technical support in different locations, cultural differences, shipping delays and terrorist acts or acts of war, among other risks. Many of these challenges are present in China, which represents a large potential market for semiconductor devices. Global uncertainties with respect to: (i) economic growth rates in various countries; (ii) sustainability of demand for electronics products; (iii) capital spending by semiconductor manufacturers; (iv) price weakness for certain semiconductor devices; and (v) political instability in regions where we have operations may also affect our business, financial condition and results of operations.

Our dependence on international sales involves a number of risks, including:

- changes in tariffs, import restrictions, export restrictions, or other trade barriers;
- unexpected changes in regulatory requirements;
- longer periods to collect accounts receivable;
- changes in export license requirements;
- political and economic instability;
- unexpected changes in diplomatic and trade relationships; and
- foreign exchange rate fluctuations.

Our sales are denominated in U.S. dollars, except for sales to our Chinese customers which are denominated in Renminbi and our Japanese customers which are denominated in Japanese yen. Increases in the value of the U.S. dollar could increase the price of our products in non-U.S. markets and make our products more expensive than competitors' products in these markets.

Denominating some sales in Japanese yen subjects us to fluctuations in the exchange rates between the U.S. dollar and the Japanese yen. For example, in the second half of 2014, the exchange rate of Japanese yen to U.S. dollar moved from 101.55 to 119.95 from June 30, 2014 to December 31, 2014. We incurred foreign currency transaction exchange losses which are included in "other income (expense), net" on the consolidated statements of operations of $1.0 million, $1.3 million and $445,000 for the years ended December 31, 2014, 2013 and 2012 respectively. The functional currency of our Chinese subsidiary and joint ventures is the local currency. We incur transaction gains or losses resulting from consolidation of expenses incurred in local currencies for these entities, as well as in translation of the assets and liabilities of their assets at each balance sheet date. If we do not effectively manage the risks associated with international sales, our revenue, cash flows and financial condition could be adversely affected.

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Changes in tariffs, import or export restrictions, Chinese regulations or other trade barriers may reduce gross margins.

We may incur increases in costs due to changes in tariffs, import or export restrictions, or other trade barriers, unexpected changes in regulatory requirements, any of which could reduce our gross margins. For example, in July 2012, we received notice of retroactive value-added taxes (VATs) levied by the tax authorities in China which applied for the period from July 1, 2011 to June 30, 2012. We expensed the retroactive VATs of approximately $1.3 million in the quarter ended June 30, 2012, which resulted in a decrease in our gross margins. These VATs will continue to negatively impact our gross margins for the future quarters. Given the relatively fluid regulatory environment in China, there could be additional tax or other regulatory changes in the future. Any such changes could directly and materially adversely impact our financial results and general business condition.

Our operating results depend in large part on continued customer acceptance of our substrate products manufactured in China and continued improvements in product quality.

We manufacture all of our products in China, and source most of our raw materials in China. We have in the past experienced quality problems with our China manufactured products. Our previous quality problems caused us to lose market share to our competitors, as some customers reduced their orders from us until our surface quality was as good and consistent as that offered by competitors and instead allocated their requirements for compound semiconductor substrates to our competitors. If we are unable to continue to achieve customer qualifications for our products, or if we continue to experience quality problems, customers may not increase purchases of our products, our China facility will become underutilized, and we will be unable to achieve revenue growth.

Changes in China's political, social and economic environment may affect our financial performance.

Our financial performance may be affected by changes in China's political, social and economic environment. The role of the Chinese central and local governments in the Chinese economy is significant. Chinese policies toward economic liberalization, and laws and policies affecting technology companies, foreign investment, currency exchange rates, taxation structure and other matters could change, resulting in greater restrictions on our ability to do business and operate our manufacturing facilities in China. Any imposition of surcharges or any increase in Chinese tax rates or reduction or elimination of Chinese tax benefits could hurt our operating results. The Chinese government could revoke, terminate or suspend our operating license for national security and similar reasons without compensation to us. If the Chinese government were to take any of these actions, we would be prevented from conducting all or part of our business. Any failure on our part to comply with governmental regulations could result in the loss of our ability to manufacture our products in China.

If there are power shortages in China, we may have to temporarily close our China operations, which would adversely impact our ability to manufacture our products and meet customer orders, and would result in reduced revenue.

In the past, China has faced power shortages resulting in power demand outstripping supply in peak periods. Instability in electrical supply has caused sporadic outages among residential and commercial consumers causing the Chinese government to implement tough measures to ease the energy shortage. If further problems with power shortages occur in the future, we may be required to make temporary closures of our subsidiary and joint venture operations. We may be unable to manufacture our products and would then be unable to meet customer orders except from inventory on hand. As a result, our revenue could be adversely impacted, and our relationships with our customers could suffer, impacting our ability to generate future revenue. In addition, if power is shut off at the facilities for our China joint ventures at any time, either voluntarily or as a result of unplanned brownouts, during certain phases of our manufacturing process including our crystal growth phase, the work in process may be ruined and rendered unusable, causing us to incur costs that will not be covered by revenue, and negatively impacting our cost of revenue and gross margins.

An outbreak of a contagious disease such as Ebola, Severe Acute Respiratory Syndrome (SARS) or the Avian Flu may adversely impact our manufacturing operations and some of our key suppliers and customers.

Any reoccurrence of SARS or an outbreak of a contagious disease, such as Avian Flu, or Ebola, may cause us to temporarily close our manufacturing operations. Similarly, if one or more of our key suppliers is required to close for an extended period, we might not have enough raw material inventories to continue manufacturing operations. In addition, while we possess management skills among our China staff that enable us to maintain our manufacturing operations with minimal on-site supervision from our U.S. based staff, our business could also be harmed if travel to or from China and the United States is restricted or inadvisable. If our manufacturing operations were closed for a significant period, we could lose revenue and market share, which would depress our financial performance and could be difficult to recapture. Finally, if one of our key customers is required to close for an extended period, we might not be able to ship product to them, our revenue would decline and our financial performance would suffer.

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Risks Related to Our Financial Results and Capital Structure

If we fail to manage periodic contractions, we may utilize our cash balances, resulting in the decline of our existing cash, cash equivalents and investment balances.

We anticipate that our existing cash resources will fund our operations and purchases of capital equipment, as well as provide adequate working capital for the next twelve months. However, our liquidity is affected by many factors including, among others, the extent to which we pursue additional capital expenditures, the level of our production, and other factors related to the uncertainties of the industry and global economies. If we fail to manage business contractions successfully we may draw down our cash reserves, which would adversely affect our financial condition, reduce our value and possibly impinge our ability to raise debt and equity funding in the future, at a time when we might need to raise additional cash. Accordingly, there can be no assurance that events in the future will not require us to seek additional capital or, if required, that such capital would be available on terms acceptable to us, if at all. As part of our effort to reduce costs, we may lose key staff, production resources and technology that we will need to replenish when end markets recover. These events could reduce our ability to grow profitably as markets recover.

Unpredictable fluctuations in our operating results could disappoint analysts or our investors, which could cause our stock price to decline.

We have experienced, and may continue to experience, significant fluctuations in our revenue and earnings. Our quarterly and annual revenue and operating results have varied significantly in the past and may vary significantly in the future due to a number of factors, including:

- our ability to develop, manufacture and deliver high quality products in a timely and cost-effective manner;
- decline in general economic conditions or downturns in the industry in which we compete;
- fluctuations in demand for our products;
- expansion of our manufacturing capacity;
- expansion of our operations in China;
- limited availability and increased cost of raw materials;
- the volume and timing of orders from our customers, and cancellations, push-outs and delays of customer orders once booked;
- fluctuation of our manufacturing yields;
- decreases in the prices of our or our competitors’ products;
- costs incurred in connection with any future acquisitions of businesses or technologies; and
- increases in our expenses, including expenses for research and development.

Due to these factors, we believe that period-to-period comparisons of our operating results may not be meaningful indicators of our future performance.

A substantial percentage of our operating expenses are fixed, and we may be unable to adjust spending to compensate for an unexpected shortfall in revenue. As a result, any delay in generating revenue could cause our operating results to fall below the expectations of market analysts or investors, which could also cause our stock price to decline.

If our operating results and financial performance do not meet the guidance that we have provided to the public, our stock price may decline.

We provide public guidance on our expected operating and financial results. Although we believe that this guidance provides our stockholders, investors and analysts with a better understanding of our expectations for the future, such guidance is comprised of forward-looking statements subject to the risks and uncertainties described in this report and in our other public filings and public statements. Our actual results may not meet the guidance we have provided. If our operating or financial results do not meet our guidance or the expectations of investment analysts, our stock price may decline.

We have adopted certain anti-takeover measures that may make it more difficult for a third party to acquire us.

Our board of directors has the authority to issue up to 2,000,000 shares of preferred stock and to determine the price, rights, preferences and privileges of those shares without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of shares of preferred stock could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. We have no present intention to issue additional shares of preferred stock.

Provisions in our amended and restated certificate of incorporation and amended and restated bylaws may have the effect of delaying or preventing a merger, acquisition or change of control, or changes in our management, which could adversely affect the market price of our common stock. The following are some examples of these provisions:

- the division of our board of directors into three separate classes, each with three-year terms;
- the right of our board to elect a director to fill a space created by a board vacancy or the expansion of the board;
- the ability of our board to alter our amended and restated bylaws; and
- the requirement that only our board or the holders of at least 10% of our outstanding shares may call a special meeting of our stockholders.

Furthermore, because we are incorporated in Delaware, we are subject to the provisions of Section 203 of the Delaware General Corporation Law. These provisions prohibit us from engaging in any business combination with any interested stockholder (a stockholder who owns 15% or more of our outstanding voting stock) for a period of three years following the time that such stockholder became an interested stockholder, unless:

- 66 % of the shares of voting stock not owned by the interested stockholder approve the merger or combination, or
- the board of directors approves the merger or combination or the transaction which resulted in the stockholder becoming an interested stockholder.

Our common stock may be delisted from The Nasdaq Global Select Market, which could negatively impact the price of our common stock and our ability to access the capital markets.

Our common stock is listed on The Nasdaq Global Select Market. The bid price of our common stock has in the past closed below the $1.00 minimum per share bid price required for continued inclusion on The Nasdaq Global Select Market under Marketplace Rule 5450(a). If the bid price of our common stock remains below $1.00 per share for thirty consecutive business days, we could be subject to delisting from the Nasdaq Global Select Market.

Any delisting from The Nasdaq Global Select Market could have an adverse effect on our business and on the trading of our common stock. If a delisting of our common stock were to occur, our common stock would trade on the OTC Bulletin Board or on the "pink sheets" maintained by the National Quotation Bureau, Inc. Such alternatives are generally considered to be less efficient markets, and our stock price, as well as the liquidity of our common stock, may be adversely impacted as a result. Delisting from The Nasdaq Global Select Market could also have other negative results, including the potential loss of confidence by suppliers and employees, the loss of institutional investor interest and fewer business development opportunities, as well as the loss of liquidity for our stockholders.

Risks Related to Our Intellectual Property

Intellectual property infringement claims may be costly to resolve and could divert management attention.

Other companies may hold or obtain patents on inventions or may otherwise claim proprietary rights to technology necessary to our business. The markets in which we compete are comprised of competitors that in some cases hold substantial patent portfolios covering aspects of products that could be similar to ours. We could become subject to claims that we are infringing patent, trademark, copyright or other proprietary rights of others. We have in the past been involved in lawsuits alleging patent infringement, and could in the future be involved in similar litigation. For example, we entered into a settlement agreement with Sumitomo Electric Industries in 2011 to settle a claim of patent infringement.

If we are unable to protect our intellectual property, we may lose valuable assets or incur costly litigation.

We rely on a combination of patents, copyrights, trademark and trade secret laws, non-disclosure agreements and other intellectual property protection methods to protect our proprietary technology. However, we believe that, due to the rapid pace of technological innovation in the markets for our products, our ability to establish and maintain a position of technology leadership also depends on the skills of our development personnel. Despite our efforts to protect our intellectual property, third parties can develop products or processes similar to ours. Our means of protecting our proprietary rights may not be adequate, and our competitors may independently develop similar technology, duplicate our products or design around our patents. We believe that at least two of our competitors have begun to ship GaAs substrates produced using a process similar to our VGF process. Our competitors may also develop and patent improvements to the VGF technology upon which we rely, and thus may limit any exclusivity we enjoy by virtue of our patents or trade secrets.

It is possible that pending or future United States or foreign patent applications made by us will not be approved, that our issued patents will not protect our intellectual property, or that third parties will challenge our ownership rights or the validity of our patents. In addition, the laws of some foreign countries may not protect our proprietary rights to as great an extent as do the laws of the United States and it may be more difficult to monitor the use of our intellectual property. Our competitors may be able to legitimately ascertain non-patented proprietary technology embedded in our systems. If this occurs, we may not be able to prevent the development of technology substantially similar to ours.

We may have to resort to costly litigation to enforce our intellectual property rights, to protect our trade secrets or know-how or to determine their scope, validity or enforceability. Enforcing or defending our proprietary technology is expensive, could cause us to divert resources and may not prove successful. Our protective measures may prove inadequate to protect our proprietary rights, and if we fail to enforce or protect our rights, we could lose valuable assets.

Risks Related to Compliance and Other Legal Matters

We need to continue to improve or implement our systems, procedures and controls.

Our operations in China and our efforts to grow our business place a significant strain on our operations and management resources. We rely on certain manual processes in our operations and in connection with consolidation of our financial results. If we fail to manage these operations or fail to effectively manage a transition from manual processes to automated processes, our operations may be disrupted.

To manage our business effectively, we may need to implement additional management information systems, further develop our operating, administrative, financial and accounting systems and controls, add experienced senior level managers, and maintain close coordination among our executive, engineering, accounting, marketing, sales and operations organizations.

We are subject to internal control evaluations and attestation requirements of Section 404 of the Sarbanes Oxley Act.

Pursuant to Section 404 of the Sarbanes Oxley Act of 2002, we must include in our Annual Report on Form 10-K a report of management on the effectiveness of our internal control over financial reporting. Ongoing compliance with this requirement is complex, costly and time-consuming. If: (1) we fail to maintain effective internal control over financial reporting; or (2) our management does not timely assess the adequacy of such internal control, we could be subject to regulatory sanctions and the public's perception of us may be adversely impacted.

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If we fail to comply with environmental and safety regulations, we may be subject to significant fines or forced to cease our operations; in addition, we could be subject to suits for personal injuries caused by hazardous materials.

We are subject to federal, state and local environmental and safety laws and regulations in all of our operating locations, including laws and regulations of China, such as laws and regulations related to the development, manufacture and use of our products, the operation of our facilities, hazardous materials, and the use of our real property. These laws and regulations govern the use, storage, discharge and disposal of hazardous chemicals during manufacturing, research and development, and sales demonstrations. If we fail to comply with applicable regulations, we could be subject to orders to cease manufacturing or substantial liability for clean-up efforts, personal injury and fines or suspension or be forced to cease our operations, and/or suspend or terminate the development, manufacture or use of certain of our products, the use of our facilities, or the use of our real property, each of which could have a material adverse effect on our business, financial condition and results of operations.

For example, in 2005, a complaint was filed against us alleging personal injury, general negligence, intentional tort, wage loss and other damages, including punitive damages, as a result of exposure of plaintiffs to high levels of gallium arsenide in gallium arsenide wafers, and methanol. Other current and/or former employees could bring litigation against us in the future. Although we have put in place engineering, administrative and personnel protective equipment programs to address these issues, our ability to expand or continue to operate our present locations could be restricted or we could be required to acquire costly remediation equipment or incur other significant expenses if we were found liable for failure to comply with environmental and safety regulations. Existing or future changes in laws or regulations in the United States and China may require us to incur significant expenditures or liabilities, or may restrict our operations. In addition, our employees could be exposed to chemicals or other hazardous materials at our facilities and we may be subject to lawsuits seeking damages for wrongful death or personal injuries allegedly caused by exposure to chemicals or hazardous materials at our facilities.

Litigation is inherently uncertain and while we would expect to defend ourselves vigorously, it is possible that our business, financial condition, results of operations or cash flows could be affected in any particular period by litigation pending and any additional litigation brought against us. In addition, future litigation could divert management's attention from our business and operations, causing our business and financial results to suffer. We could incur defense or settlement costs in excess of the insurance covering these litigation matters, or that could result in significant judgments against us or cause us to incur costly settlements, in excess of our insurance limits.

In addition, from time to time, the Chinese government issues new regulations, which may require additional actions on our part to comply. On February 27, 2015, the China State Administration of Work Safety updated its list of hazardous substances. The previous list, which was published in 2002, did not restrict the materials that we use in our wafers. The new list added gallium arsenide. As a result of the newly published list, we were required to obtain a permit by May 1, 2015 to continue to manufacture our gallium arsenide substrate wafers. We initiated discussions with the local district agency to obtain the requisite permit. On May 4, 2015, we were instructed by the local district agency that because we had not yet received the requisite permit, we should cease manufacturing our gallium arsenide substrate wafers or we should obtain permission to continue manufacturing our gallium arsenide substrate wafers from a municipal-level office, such as the Beijing municipal authority. The Beijing municipal authority accepted our application on May 7, 2015 and our application is under review. There can be assurances that we will receive the requisite permit from the Beijing municipal authority or from any other Chinese governmental authority. If we do not receive the requisite permit to continue to manufacture gallium arsenide substrate wafers, we may be required to cease manufacturing such wafers until we receive the requisite permit. A halt to our production of gallium arsenide substrate wafers could result in our furloughing approximately several hundred manufacturing employees. If we obtain the requisite permit after halting our production, we might not be able to recommence manufacturing gallium arsenide substrate wafers immediately because we may need to rebuild our chain and we may not be able to rehire our furloughed manufacturing employees. We could also lose customers to our competitors because of our inability to supply gallium arsenide substrate wafers. Any of these could materially and adversely impact our results of operations and our financial condition.

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

Repurchases of Equity Securities

On February 21, 2013, our Board of Directors approved a stock repurchase program pursuant to which we may repurchase up to $6.0 million of our outstanding common stock through February 27, 2014. These purchases can be made from time to time in the open market and are funded from our existing cash balances and cash generated from operations. During 2013, we repurchased approximately 285,000 shares at an average price of $2.51 per share for a total purchase price of $716,000 under the stock repurchase program. As of December 31, 2013, approximately $5.3 million remained available for future repurchases under this program. No shares were repurchased in 2014 under this program and the plan expired on February 27, 2014. On October 27, 2014, our Board of Directors approved a stock repurchase program pursuant to which we may repurchase up to $5.0 million of our outstanding common stock. These repurchases can be made from time to time in the open market and are funded from our existing cash balances and cash generated from operations. During the three months ended March 31, 2015, we repurchased approximately 230,000 shares at an average price of $2.67 per share for a total purchase price of $617,000 under the stock repurchase program. As of March 31, 2015, approximately $4.4 million remained available for future repurchases under this program. The following table provides additional details regarding our repurchase activity during the three months ended March 31, 2015:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximately Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs (in thousands)
January 1,2015 – January 31, 2015	—	—	—	$ 5,000,000
February 1, 2015 – February 28, 2015	—	—	—	$ 5,000,000
March 1, 2015 – March 31, 2015	229,738	$ 2.67	229,738	$ 4,382,902

Item 3. Defaults upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None

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Item 6. Exhibits

a. Exhibits

Exhibit Number	Description
31.1	Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS* XBRL Instance.
101.SCH* XBRL Taxonomy Extension Schema.
101.CAL* XBRL Taxonomy Extension Calculation Linkbase.
101.LAB* XBRL Taxonomy Extension Label Linkbase.
101.PRE* XBRL Taxonomy Extension Presentation Linkbase.

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

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SIGNATURES

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

AXT, INC.

Dated: May 8, 2015 By: /s/ MORRIS S. YOUNG
Morris S. Young
Chief Executive Officer
(Principal Executive Officer)

/s/ GARY L. FISCHER
Gary L. Fischer
Chief Financial Officer and Corporate Secretary
(Principal Financial Officer and Principal Accounting Officer)

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EXHIBIT INDEX

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