

AXT INC
Form 10-Q
November 04, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the quarterly period ended September 30, 2016

Or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the transition period from to

Commission File Number 000-24085

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AXT, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	94-3031310
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

4281 Technology Drive, Fremont, California 94538

(Address of principal executive offices) (Zip code)

(510) 438-4700

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 3, 2016
Common Stock, \$0.001 par value	32,559,384

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AXT, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

AXT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share data)

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 29,661	\$ 24,875
Short-term investments	9,563	11,437
Accounts receivable, net of allowances of \$1,026 and \$985 as of September 30, 2016 and December 31, 2015	18,380	18,468
Inventories	38,731	38,012
Prepaid expenses and other current assets	5,265	4,096
Total current assets	101,600	96,888
Long-term investments	8,124	7,691
Property, plant and equipment, net	29,385	31,422
Related party notes receivable – long-term	1,735	1,781
Other assets	12,084	14,114
Total assets	\$ 152,928	\$ 151,896
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,277	\$ 6,460
Accrued liabilities	5,011	6,381
Total current liabilities	12,288	12,841
Long-term portion of royalty payments	719	1,150
Other long-term liabilities	307	344
Total liabilities	13,314	14,335
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock Series A, \$0.001 par value; 2,000 shares authorized; 883 shares issued and outstanding as of September 30, 2016 and December 31, 2015 (Liquidation preference of \$6.6 million and \$6.5 million as of September 30, 2016 and December 31, 2015.)	3,532	3,532
	32	32

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Common stock, \$0.001 par value; 70,000 shares authorized; 32,559 and 32,548 shares issued and outstanding as of September 30, 2016 and December 31, 2015.

Additional paid-in-capital	195,863	194,646
Accumulated deficit	(67,199)	(70,621)
Accumulated other comprehensive income	2,529	4,382
Total AXT, Inc. stockholders' equity	134,757	131,971
Noncontrolling interests	4,857	5,590
Total stockholders' equity	139,614	137,561
Total liabilities and stockholders' equity	\$ 152,928	\$ 151,896

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Revenue	\$ 21,872	\$ 18,371	\$ 61,080	\$ 59,445
Cost of revenue	14,294	13,766	42,222	45,706
Gross profit	7,578	4,605	18,858	13,739
Operating expenses:				
Selling, general, and administrative	3,313	3,659	10,106	12,685
Research and development	1,566	1,657	4,419	4,287
Restructuring charge	—	—	226	—
Total operating expenses	4,879	5,316	14,751	16,972
Income (loss) from operations	2,699	(711)	4,107	(3,233)
Interest income, net	105	102	303	307
Equity in earnings (loss) of unconsolidated joint ventures	(581)	167	(1,437)	777
Other income, net	164	496	682	1,755
Income (loss) before provision for income taxes	2,387	54	3,655	(394)
Provision for income taxes	176	7	713	334
Net income (loss)	2,211	47	2,942	(728)
Less: Net (income) loss attributable to noncontrolling interests	18	(5)	480	(257)
Net income (loss) attributable to AXT, Inc.	\$ 2,229	\$ 42	\$ 3,422	\$ (985)
Net income (loss) attributable to AXT, Inc. per common share:				
Basic	\$ 0.07	\$ (0.00) *	\$ 0.10	\$ (0.03)
Diluted	\$ 0.07	\$ (0.00) *	\$ 0.10	\$ (0.03)
Weighted average number of common shares outstanding:				
Basic	32,110	31,988	32,043	32,262
Diluted	33,138	31,988	32,615	32,262

* Net loss to AXT, Inc. per common share resulted due to the accrual of preferred dividend liquidation preference during the three months ended September 30, 2015.

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income (loss)	\$ 2,211	\$ 47	\$ 2,942	\$ (728)
Other comprehensive loss, net of tax:				
Change in foreign currency translation loss, net of tax	(233)	(2,626)	(1,801)	(2,321)
Change in unrealized loss on available-for-sale investments, net of tax	(112)	(134)	(253)	(484)
Total other comprehensive loss, net of tax	(345)	(2,760)	(2,054)	(2,805)
Comprehensive income (loss)	1,866	(2,713)	888	(3,533)
Less: Comprehensive loss attributable to noncontrolling interests	48	335	681	41
Comprehensive income (loss) attributable to AXT, Inc.	\$ 1,914	\$ (2,378)	\$ 1,569	\$ (3,492)

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income (loss)	\$ 2,942	\$ (728)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,620	4,197
Amortization of marketable securities premium	85	168
Stock-based compensation	789	1,051
Provision for doubtful accounts	—	211
Realized gain on sale of available for sale securities	(429)	(859)
Loss (gain) on disposal of equipment	(5)	16
Loss (gain) from equity method investments, net	1,437	(777)
Changes in operating assets and liabilities:		
Accounts receivable	(72)	363
Inventories	(1,092)	13
Prepaid expenses and other current assets	(1,259)	1,920
Other assets	435	329
Accounts payable	949	(1,053)
Accrued liabilities	(1,301) *	(2,032) *
Other long-term liabilities, including royalties	(591)	(559)
Net cash provided by operating activities	5,508	2,260
Cash flows from investing activities:		
Purchases of equipment	(2,200)	(3,508)
Proceeds from sale of equipment	35	2
Purchases of available for sale securities	(10,784)	(13,044)
Proceeds from sales and maturities of available for sale securities	12,316	14,309
Investments in non-marketable equity investments	—	(162)
Dividends received from equity method investments	—	286
Net cash used in investing activities	(633)	(2,117)
Cash flows from financing activities:		
Proceeds from common stock options exercised	428	165
Repurchase of the Company's common stock, including commission	—	(2,254)
Dividends paid by joint ventures to their minority shareholders	(39)	(102)
Net cash provided by (used in) financing activities	389	(2,191)
Effect of exchange rate changes on cash and cash equivalents	(478)	(581)
Net increase (decrease) in cash and cash equivalents	4,786	(2,629)

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Cash and cash equivalents at the beginning of the period	24,875	28,814
Cash and cash equivalents at the end of the period	\$ 29,661	\$ 26,185
Supplemental disclosures:		
Income taxes paid	—	—

* Dividend accrued but not paid by joint ventures of \$520 and \$544 was included in accrued liabilities as of September 30, 2016 and September 30, 2015, respectively.

See accompanying notes to condensed consolidated financial statements.

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AXT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements of AXT, Inc. (“AXT,” the “Company,” “we,” “us,” and “our” refer to AXT, Inc. and 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 this interim quarterly financial report 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 2015 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the “SEC”) on March 11, 2016 and our Quarterly Reports on Form 10-Q for the three months ended March 31, 2016 and June 30, 2016 filed with the SEC on May 6, 2016 and August 5, 2016, respectively.

The condensed consolidated financial statements include the accounts of AXT, our wholly-owned subsidiary, Beijing Tongmei Xtal Technology Co., Ltd., and our majority-owned, or significantly controlled 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 controlling interests, 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 partially-owned subsidiaries that we consolidate, 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 September 30, 2016 and December 31, 2015, our cash, cash equivalents and investments are classified as follows (in thousands):

	September 30, 2016				December 31, 2015			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value
Classified as:								
Cash	\$ 16,957	\$ —	\$ —	\$ 16,957	\$ 10,289	\$ —	\$ —	\$ 10,289
Cash equivalents:								
Certificates of deposit 1	12,704	—	—	12,704	14,586	—	—	14,586
Total cash and cash equivalents	29,661	—	—	29,661	24,875	—	—	24,875
Investments (available for sale):								
Certificates of deposit 2	9,047	2	(9)	9,040	9,795	1	(13)	9,783
Corporate bonds	8,488	—	(24)	8,464	8,776	—	(63)	8,713
Corporate equity securities	48	135	—	183	200	432	—	632
Total investments	17,583	137	(33)	17,687	18,771	433	(76)	19,128
Total cash, cash equivalents and investments	\$ 47,244	\$ 137	\$ (33)	\$ 47,348	\$ 43,646	\$ 433	\$ (76)	\$ 44,003
Contractual maturities on investments:								
Due within 1 year	\$ 9,436			\$ 9,563	\$ 11,022			\$ 11,437
Due after 1 through 5 years	8,147			8,124	7,749			7,691
	\$ 17,583			\$ 17,687	\$ 18,771			\$ 19,128

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 holding of corporate equity securities consists of common stock of GCS Holdings, Inc. (“GHI”) (previously Global Communication Semiconductors, Inc.), a Taiwan publicly-traded company. Previously, we also owned the common stock of Intelligent Epitaxy Technology, Inc. (“IntelliEpi”). We began classifying IntelliEpi stock as an available-for-sale security upon its initial public offering in 2013. We sold our remaining IntelliEpi stock in the second quarter of 2015. During the nine months ended September 30, 2015, our cash proceeds from sales of available-for-sale investments was \$902,000. Our cost was \$43,000 and our gross realized gain from sales of available-for-sale investments was \$859,000. As of September 30, 2016, we no longer hold any IntelliEpi stock.

We began classifying GHI as an available-for-sale security in the second quarter of 2015 when we determined that there was sufficient trading volume in the exchange for the stock to be deemed readily marketable. An unrealized gain of \$135,000 net of tax was recorded as of September 30, 2016. This security is valued at fair market value at September 30, 2016 and will be marked to market with changes through other comprehensive income until sold. There is no assurance that we will realize this value when the stock is sold in the future. During the three months ended September 30, 2016, we sold some of our GHI stock and our cash proceeds from sales of available-for-sale investments was \$113,000. Our cost was \$29,000 and our gross realized gain from sales of available-for-sale investments was \$84,000. During the nine months ended September 30, 2016, we sold some of our GHI stock and our cash proceeds from

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sales of available-for-sale investments was \$581,000. Our cost was \$152,000 and our gross realized gain from sales of available-for-sale investments was \$429,000.

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 September 30, 2016 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 September 30, 2016. 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 September 30, 2016 (in thousands):

	In Loss Position < 12 months		In Loss Position > 12 months		Total In Loss Position	
	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)	Fair Value	Gross Unrealized (Losses)
As of September 30, 2016						
Investments:						
Certificates of deposit	\$ 3,541	\$ (9)	\$ 1,440	\$ —	\$ 4,981	\$ (9)
Corporate bonds	5,060	(17)	3,404	(7)	8,464	(24)
Total in loss position	\$ 8,601	\$ (26)	\$ 4,844	\$ (7)	\$ 13,445	\$ (33)

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, 2015 (in thousands):

	In Loss Position < 12 months		In Loss Position > 12 months		Total In Loss Position	
	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)	Fair Value	Gross Unrealized (Loss)
As of December 31, 2015						
Investments:						
Certificates of deposit	\$ 4,509	\$ (11)	\$ 3,543	\$ (2)	\$ 8,052	\$ (13)
Corporate bonds	6,866	(56)	1,847	(7)	8,713	(63)

Total in loss position	\$ 11,375	\$ (67)	\$ 5,390	\$ (9)	\$ 16,765	\$ (76)
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Investments in Privately-held Companies

We have made strategic investments in private companies located in China in order to gain access at a competitive cost to raw materials that are critical to our substrate business (see Note 7). The investment balances for all of these companies, including minority investments indirectly in privately-held companies made by our consolidated subsidiaries, are accounted for under the equity method and included in “other assets” in the condensed consolidated balance sheets and totaled \$10.5 million and \$12.1 million as of September 30, 2016 and December 31, 2015, respectively.

As noted above, in the second quarter of 2015, we re-classified our minority investment in GHI, which was accounted for under the cost method, as an available-for-sale security and valued the security at fair market value. As of September 30, 2016 and December 31, 2015, we did not maintain any investments under the cost method.

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Fair Value Measurements

We invest primarily in money market accounts, certificates of deposits, corporate bonds and notes, and government securities. 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, observable 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 and 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 bank statements, quoted market prices, broker or dealer statements or 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 condensed consolidated balance sheet and classified as Level 3 assets and liabilities. As of September 30, 2016 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.

There were no changes in valuation techniques or related inputs in the three months ended September 30, 2016. There have been no transfers between fair value measurements levels during the three months ended September 30, 2016.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 as of September 30, 2016 (in thousands):

	Quoted Prices in Active Markets of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Balance as of September 30, 2016			

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Assets:

Cash equivalents and investments:

Certificates of deposit	\$ 21,744	\$ —	\$ 21,744	\$ —
Corporate bonds	8,464	—	8,464	—
Corporate equity securities	183	183	—	—
Total	\$ 30,391	\$ 183	\$ 30,208	\$ —

Liabilities:

Foreign currency hedge obligations	\$ 53	\$ —	\$ —	\$ 53
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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, 2015 (in thousands):

	Balance as of December 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	\$ 24,369	\$ —	\$ 24,369	\$ —
Corporate bonds	8,713	—	8,713	—
Corporate equity securities	632	632	—	—
Total	\$ 33,714	\$ 632	\$ 33,082	\$ —
Liabilities:				
Foreign currency hedge obligations	\$ 36	\$ —	\$ —	\$ 36

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 the equity or cost method (See Note 7). We did not record other-than-temporary impairment charges for either of these investments during the three and nine months ended September 30, 2016 and 2015.

Note 3. Inventories

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

	September 30, 2016	December 31, 2015
Inventories:		
Raw materials	\$ 19,355	\$ 19,532
Work in process	16,759	16,007
Finished goods	2,617	2,473
	\$ 38,731	\$ 38,012

As of September 30, 2016 and December 31, 2015, carrying values of inventories were net of inventory reserve of \$11.6 million and \$12.0 million, respectively, for excess and obsolete inventory and \$297,000 and \$625,000, respectively, for lower of cost or market reserves.

Note 4. Property, Plant and Equipment, Net

The components of our property, plant and equipment are summarized below (in thousands):

	September 30, 2016	December 31, 2015
Property, plant and equipment:		
Machinery and equipment, at cost	\$ 41,225	\$ 40,899
Less: accumulated depreciation and amortization	(37,462)	(36,044)
Building, at cost	30,324	30,388
Less: accumulated depreciation and amortization	(9,765)	(9,170)
Leasehold improvements, at cost	5,057	5,059
Less: accumulated depreciation and amortization	(3,601)	(3,306)
Construction in progress	3,607	3,596

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\$ 29,385 \$ 31,422

Note 5. Accrued Liabilities

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

	September 30, 2016	December 31, 2015
Accrued compensation and related charges	\$ 1,161	\$ 2,129
Current portion of royalty payments	575	575
Dividends payable by consolidated joint ventures	520	534
Accrued professional services	531	709
Accrued product warranty	266	497
Accrued income taxes	249	225
Other accrued liabilities	1,709	1,712
	\$ 5,011	\$ 6,381

Note 6. 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 \$1.6 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 three 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 2017. As of September 30, 2016, and December 31, 2015, we included \$1.6 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 September 30, 2016 and December 31, 2015, amounts payable of \$2.4 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 September 30, 2016 and December 31, 2015, amounts receivable of \$370,000 and \$473,000, respectively, 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 each of the three months ended September 30, 2016 and 2015, Jin Mei has recorded \$0 income from agency sales. For each of the nine months ended September 30, 2016 and 2015, Jin Mei has recorded \$1,000 income from agency sales, 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. (“BoYu”). 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 31st of each year.

Tongmei has paid certain amounts on behalf of Donghai County Dongfang High Purity Electronic Materials Co., Ltd. (“Dongfang”), its equity investment entity, to purchase materials. The original agreement was signed between Tongmei and Dongfang in 2014 and the date of repayment was set as December 31, 2015. In 2015, both parties agreed to delay the date of repayment to December 31, 2017. As of September 30, 2016 and December 31, 2015, the balance of \$111,000 and \$114,000, respectively, were included in “Related party notes receivable – long term” in our condensed consolidated balance sheets.

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In April 2014, Tongmei loaned an additional of \$45,000 to Dongfang. The loan bears interest at 6.15% per annum and the principal and accrued interest totaling \$52,000 as of September 30, 2016 are due on December 31, 2016. As of September 30, 2016, this balance, including both principal and accrued interest, was included in “Related party notes receivable – long term” in our condensed consolidated balance sheets.

Tongmei purchases raw materials from one of our equity investment entities, Emei Shan Jiamei Materials Co. Ltd. (“Jiamei”), for production in the ordinary course of business. As of September 30, 2016 and December 31, 2015, amounts payable of \$256,000 and \$70,000, respectively, were included in “accounts payable” in our condensed consolidated balance sheets.

Tongmei also purchases raw materials from one of our equity investment entities, Xilingol Tongli Germanium Refine Co. Ltd. (“Tongli”), for production in the ordinary course of business. As of September 30, 2016 and December 31, 2015, amounts payable of \$477,000 and \$0, respectively, were included in “accounts payable” in our condensed consolidated balance sheets.

In April 2016, our consolidated joint venture, BoYu, provided a personal loan of \$180,000 to one of its executive officers. This loan is secured by the officer’s shares in BoYu. The loan bears interest at 2.75% per annum. Principal and accrued interest are due on March 31, 2019. As of September 30, 2016, including both principal and accrued interest, was included in “prepaid expenses and other current assets” 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 former 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 September 30, 2016 and December 31, 2015, amounts payable to Kaide of \$457,000 and \$379,000, 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, directors, and our consolidated subsidiaries. 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 7 for further details.

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Note 7. Investments in Privately-Held Companies

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

The investments are summarized below (in thousands):

Company	Investment Balance as of		Accounting Method	Ownership Percentage	
	September 30, 2016	December 31, 2015			%
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	%