APPLIED OPTOELECTRONICS, INC.
Form 10-Q
November 12, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from __________ to __________

Commission File Number: 001-36083

Applied Optoelectronics, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**76-0533927**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

13115 Jess Pirtle Blvd.

Sugar Land, TX 77478

(Address of principal executive offices)

(281) 295-1800

(Registrant's telephone number)

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

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

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller reporting company	o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: as of November 3, 2014 there were 14,816,055 shares of the registrant's Common Stock outstanding.

Applied Optoelectronics, Inc.

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Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share data)

	September 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	$ 37,034	$ 22,006
Restricted cash	787	775
Short-term investments	7,958	7,970
Accounts receivable - trade, net	24,181	22,089
Inventories	33,129	19,608
Prepaid expenses and other current assets	7,847	5,488
Total current assets	110,936	77,936
Property, plant and equipment, net	51,267	31,134
Land use rights, net	931	959
Intangible assets, net	3,830	851
Other assets, net	1,190	177
TOTAL ASSETS	$ 168,154	$ 111,057
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of notes payable and long-term debt	$ 9,392	$ 17,185
Accounts payable	22,616	15,010
Bank acceptance payable	2,115	2,347
Accrued liabilities	4,960	4,515
Total current liabilities	39,083	39,057
Notes payable and long-term debt, less current portion	14,000	8,923
Other long term liabilities	1,250	–
TOTAL LIABILITIES	54,333	47,980
Stockholders' equity (deficit):		
Preferred Stock: 5,000 shares authorized; no shares issued and outstanding at September 30, 2014 and December 31, 2013, $0.001 par value	–	–
	15	13

Common Stock: 45,000 shares authorized; 14,815 shares issued and outstanding at September 30, 2014, $0.001 par value; 12,644 shares issued and outstanding at December 31, 2013, $0.001 par value		
Additional paid-in capital	191,439	144,023
Accumulated other comprehensive gain	2,109	2,364
Accumulated deficit	(79,742)	(83,323)
TOTAL STOCKHOLDERS' EQUITY	113,821	63,077
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 168,154	$ 111,057

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

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Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except share and per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenue, net	$36,549	$20,766	$94,058	$54,680
Cost of goods sold	24,403	14,445	62,071	38,327
Gross profit	12,146	6,321	31,987	16,353
Operating expenses				
Research and development	4,194	2,210	11,749	6,112
Sales and marketing	1,622	1,034	4,452	2,994
General and administrative	4,458	2,436	11,964	7,257
Total operating expenses	10,274	5,680	28,165	16,363
Income (loss) from operations	1,872	641	3,822	(10)
Other income (expense)				
Interest income	95	15	280	50
Interest expense	(55)	(323)	(277)	(925)
Other expense, net	(258)	58	(57)	–
Total other expense	(218)	(250)	(54)	(875)
Income (loss) before income taxes	1,654	391	3,768	(885)
Income taxes	(77)	–	(187)	–
Net income (loss)	$1,577	$391	$3,581	$(885)
Net income (loss) per share				
Basic	$0.11	$0.04	$0.25	$(3.24)
Diluted	$0.10	$0.04	$0.24	$(3.24)
Weighted average shares used to compute net income (loss) per share				
Basic	14,805,668	8,995,727	14,135,184	272,878
Diluted	15,594,544	9,154,602	14,949,827	272,878

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

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net income (loss)	$1,577	$391	$3,581	$(885)
Foreign currency translation adjustment, net of tax	(115)	66	(255)	305
Comprehensive income (loss)	$1,462	$457	$3,326	$(580)

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

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Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Nine months ended September 30, 2014	2013
Operating activities:		
Net income (loss)	$3,581	$(885)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Provision for obsolete inventory	1,182	550
Depreciation and amortization	4,349	2,436
Loss on disposal of assets	26	–
Share-based compensation and warrant expense	1,494	375
Changes in operating assets and liabilities:		
Accounts receivable	(2,171)	(3,446)
Inventory	(15,016)	(4,389)
Other current assets	(2,404)	(1,850)
Accounts payable	9,137	4,350
Accrued liabilities	487	405
Net cash provided by (used in) operating activities	665	(2,454)
Investing activities:		
Purchase of short-term investments	(53)	–
Purchase of property, plant and equipment	(24,773)	(4,697)
Proceeds from disposal of equipment	45	–
Deposits and deferred charges	(1,034)	(37)
Purchase of intangible assets	(3,237)	(83)
Net cash used in investing activities	(29,052)	(4,817)
Financing activities:		
Proceeds from issuance of notes payable and long-term debt	3,150	2,851
Principal payments of long-term debt and notes payable	(8,076)	(192)
Proceeds from line of credit borrowings	30,294	16,159
Repayments of line of credit borrowings	(27,924)	(15,406)
Proceeds from bank acceptance payable	5,337	4,746
Repayments of bank acceptance payable	(5,545)	(3,282)
Increase in restricted cash	(21)	(511)
Exercise of stock options	310	87
Exercise of warrants	–	494
Proceeds from public offering, net	45,630	(1,251)
Net cash provided by financing activities	43,155	3,695
Effect of exchange rate changes on cash	260	178
Net increase (decrease) in cash	15,028	(3,398)
Cash and cash equivalents at beginning of period	22,006	10,723

Cash and cash equivalents at end of period	$37,034	$7,325
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest	306	852
Income taxes	148	2

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

Applied Optoelectronics, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Description of Business

Business Overview

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

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

Interim Financial Statements

The condensed consolidated financial statements of the Company, as of September 30, 2014 and December 31, 2013 and for the three and nine months ended September 30, 2014 and 2013, have been prepared in accordance with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In accordance with those rules and regulations, the Company has omitted certain information and notes normally provided in the Company’s annual consolidated financial statements. In the opinion of management, the condensed consolidated financial statements contain all adjustments, except as otherwise noted, necessary for the fair presentation of the Company’s financial position and results of operations for the periods presented. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles (“GAAP”). These condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company’s Annual Report on Form 10-K (“Annual Report”) for the fiscal year ended December 31, 2013. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

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

Note 2. Significant Accounting Policies

There have been no changes in the Company’s significant accounting policies for the three months ended September 30, 2014, as compared to the significant accounting policies described in its Annual Report.

Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

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Note 3. Fair Value of Financial Instruments

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

	As of September 30, 2014				**As of December 31, 2013**			
	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)	Total
Assets:								
Short term investments	$7,958	$–	$ –	$7,958	$7,970	$–	$ –	$7,970
Total assets	$7,958	$–	$ –	$7,958	$7,970	$–	$ –	$7,970
Liabilities:								
Bank acceptance payable	–	2,115	–	2,115	–	2,347	–	2,347
Total liabilities	$–	$2,115	$ –	$2,115	$–	$2,347	$ –	$2,347

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

Note 4. Earnings Per Share

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013

Numerator:				
Net income (loss)	$1,577	$391	$3,581	$(885)
Denominator:				
Weighted average shares used to compute net income (loss) per share				
Basic	14,806	8,995	14,135	273
Effective of dilutive options and warrants	789	160	815	–
Diluted	15,595	9,155	14,950	273
Net income (loss) per share				
Basic	$0.11	$0.04	$0.25	$(3.24)
Diluted	$0.10	$0.04	$0.24	$(3.24)

The following potentially dilutive securities were excluded from the computation of diluted net income (loss) per share as their effect would have been anti-dilutive (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Employee stock options	–	1,347	–	1,484
Preferred stock warrants	–	10	–	33
Restricted stock units	–	–	–	–
	–	1,357	–	1,517

Note 5. Inventory

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

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	September 30, 2014	December 31, 2013
Raw materials	$ 4,824	$ 8,832
Work in process	14,957	8,708
Finished goods	13,348	2,068
	$ 33,129	$ 19,608

The lower of cost or market adjustment expensed for inventory for the three months ended September 30, 2014 and 2013 was $0.4 million and $0.1 million, respectively. The lower of cost or market adjustment expensed for inventory for the nine months ended September 30, 2014 and 2013 was $1.1 million and $0.5 million, respectively.

Note 6. Property, Plant & Equipment

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

	September 30, 2014	December 31, 2013
Land improvements	$ 103	$ 103
Building and improvements	16,104	16,016
Machinery and equipment	52,694	37,490
Furniture and fixtures	1,434	1,047
Computer equipment and software	4,567	3,563
Transportation equipment	288	188
	75,190	58,407
Less accumulated depreciation and amortization	(30,977)	(28,145)
	44,213	30,262
Construction in progress	5,953	139
Land	1,101	733
Property, plant and equipment, net	$ 51,267	$ 31,134

For the three and nine months ended September 30, 2014, depreciation expense of property, plant and equipment was $1.6 million and $4.1 million, respectively.

Note 7. Notes Payable and Long-Term Debt

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

	September 30, 2014	December 31, 2013
Long-Term and Short-Term Debt		
Term loan with a U.S. bank with monthly payments of principal and interest at prime plus 0.75% (floor rate: 4%), maturing November 15, 2014	$–	$ 3,076
Revolving line of credit with a U.S. bank up to $15,000 with interest at LIBOR plus 2.75%, maturing July 15, 2017	14,000	7,000
Term loan with a U.S. bank with monthly payments of principal and interest at LIBOR plus 2.75%, maturing July 1, 2019	–	1,850
Revolving line of credit with a China bank up to $12,000 with interest at 108% of China prime rate which was 6.48% in 2013	–	7,053
Revolving line of credit with a China bank up to $3,250 with interest ranged from 2.03% to 2.13% with various maturity dates from October 2014 to December 2014	1,309	2,413
Revolving line of credit with a Taiwan bank up to $4,000 with interest at Taiwan Time Deposit Interest Rate Index plus 0.41%, maturing December 2014	3,676	3,795
Revolving line of credit with a Taiwan bank up to $4,000 with interest at Taiwan Time Deposit Interest Rate Index plus 0.41%, maturing January 2015	3,749	–
Note payable to a finance company due in monthly installments with 4.95% interest, maturing July 30, 2015	658	921
Total	23,392	26,108
Less current portion	9,392	17,185
Long term portion	$14,000	$ 8,923
Bank Acceptance Payable		
Bank acceptance notes issued to vendors with a zero percent interest rate, a 30% guarantee deposit of $655, and maturity dates ranging from October 2014 to March 2015	$2,115	$ 2,347

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The current portion of long-term debt is the amount payable within one year of the balance sheet date of September 30, 2014. The prime rate of interest was 3.25% on December 31, 2013. The one-month LIBOR rate was 0.15% on September 30, 2014.

The U.S. bank loans and line of credit agreement require the Company to meet certain financial covenants including a minimum current ratio. Collateral for the U.S. bank loans and line of credit includes substantially all of the assets of the Company. As of September 30, 2014, the Company was in compliance with all of its financial and operational covenants associated with these loans. As of September 30, 2014, the Company had $1.0 million of unused borrowing capacity on its line of credit, $3.1 million on its real estate term loan and $5.0 million on its equipment term loan.

On July 15, 2014, the Company renewed its revolving line of credit with a U.S. bank, increasing the line from $7.0 million to $15.0 million, and extending the maturity date to July 15, 2017. The interest rate on this line of credit is the LIBOR Borrowing Rate plus 2.75%.

On July 31, 2014, the Company renewed its $5.0 million credit agreement with a U.S. bank, extending the maturity date to July 1, 2019. The interest rate on this line of credit is the LIBOR Borrowing Rate plus 2.75%.

The Company, through its China subsidiary, established RMB and USD currency lines of credit for $12.0 million and $3.3 million, respectively, with a China bank as of September 30, 2014. The interest rate for the RMB line of credit is 108% of the China prime rate. The interest rate for the USD line of credit ranged from 2.03% to 2.13%. These credit lines are revolving lines that are renewable by its anniversary. Collateral for the loans includes the land use rights, building and equipment located in China. As of September 30, 2014, the Company had approximately $14.0 million of unused borrowing capacity.

The Company extended its equipment financing agreement of $1.0 million with a Taiwan bank in 2013. The financing agreement required equipment collateral. The agreement requires monthly installment payments over 24 months and ends in July 2015. The financing agreement bears interest at the rate of 4.95%.

The Company, through its Taiwan branch, established two $4.0 million revolving lines of credit with Taiwan banks in 2013 totaling $8.0 million. The financing agreements require collateral of its time deposits of $8.0 million that is included in short-term investment. The two revolving lines of credit bear interest at a rate (which adjusts quarterly) equal to the Taiwan Time Deposit Interest Rate Index plus 0.41%, currently 1.78%, and at a base rate equal to TAIBOR plus 1%, currently 1.75%. As of September 30, 2014, $7.4 million was outstanding under these credit facilities.

Note 8. Accrued Liabilities

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

	September 30, 2014	December 31, 2013
Accrued payroll	$ 3,013	$ 2,279
Accrued employee benefits	645	489
Accrued taxes	275	270
Accrued interest	7	34
Advanced payments	70	128
Accrued commissions	63	148
Accrued other	887	1,167
	$ 4,960	$ 4,515

Note 9. Other Income and Expense

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Unrealized foreign exchange gain (loss)	$(203)	$(65)	$(205)	$(257)
Realized foreign exchange gain (loss)	(17)	57	53	(7)
Government subsidy income	–	75	108	270
Other non-operating gain (loss)	(11)	(9)	16	(14)
Gain (loss) on disposal of assets	(27)	–	(29)	8
	$(258)	$58	$(57)	$–

Note 10. Share-Based Compensation

The Accounting Standards Codification (“ASC”) 718 requires companies to record compensation expense for stock options measured at fair value, on the date of grant, using an option –pricing model.

The Company’s board of directors and stockholders previously approved the 1998 Share Incentive Plan, the 2000 Share Incentive Plan, the 2004 Share Incentive Plan and the 2006 Share Incentive Plan, (collectively the “Prior Plans”). Following the Company’s initial public offering, no further awards will be granted under the Prior Plans. However, all outstanding awards under the Prior Plans will continue to exist and will continue to be governed by their existing terms.

On April 12, 2013, the Company’s board of directors adopted and approved the Company’s 2013 Equity Incentive Plan, (the “2013 Plan”), and it was subsequently approved by the Company’s stockholders on May 21, 2013.

The Company provides share-based compensation to employees, consultants and non-employee directors. Share-based awards for the Prior Plans and the 2013 Plan generally vest over a four year period and have a maximum term of ten years. Stock options under these plans have been granted with an exercise price equal to the fair market value of the common stock on the date of the grant. Nonqualified and incentive stock options and restrictive stock units (“RSUs”) have been granted from these plans. Prior to the Company's initial public offering, the fair market value of the Company's stock had been historically determined by the board of directors and from time to time with the assistance of third party valuation specialists.

As of September 30, 2014, the Company had outstanding equity awards to purchase 1,437,044 shares of common stock under its share incentive plans with a weighted average exercise price of $8.94.

The following table summarizes employee share-based compensation expense resulting from stock options and RSUs for the periods indicated (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Cost of sales	$7	$14	$60	$40
Research and development	28	12	84	36
Sales and marketing	24	11	72	32
General and administrative	428	98	1,278	267
	$487	$135	$1,494	$375

The following is a summary of stock option activity during the nine month period ending September 30, 2014 (in thousands, except price data):

	Shares	Weighted Average Exercise Price	Weighted Average Fair Value	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding, December 31, 2013	1,468	$ 8.38	$ 4.17		$ 9,731
Granted	108	13.84	7.24		–
Exercised	(108)	6.21	2.56		1,658
Forfeited	(30)	8.96	6.82		363
Expired	(1)	6.21	2.21		11
Outstanding, September 30, 2014	1,437	$ 8.94	$ 4.47	8.332	$ 10,287
Exercisable, September 30, 2014	532	$ 7.69	$ 3.22	7.543	$ 4,473
Vested and expected to vest	1,335	$ 8.87	$ 4.40	8.290	$ 9,652

As of September 30, 2014, total compensation cost related to unvested stock options not yet recognized was $3.9 million, which is expected to be expensed over a weighted-average period of 2.85 years. The aggregated intrinsic value of options outstanding and options exercisable as of September 30, 2014 was $10.3 million and $4.5 million, respectively.

Under the 2013 Plan, participants may be granted RSUs, representing an unfunded, unsecured right to receive common stock on the date specified in the recipient's award. The Company recognizes compensation expense on a straight-line basis over the applicable vesting term of the award.

During the three months ended September 30, 2014, the Company granted 21,226 RSUs with a total grant-date fair market value of $0.4 million. As of September 30, 2014, there was approximately $0.2 million of unrecognized compensation cost related to RSUs.

Note 11. Stockholders' Equity

1. *Common Stock*

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

2. *Convertible Preferred Stock*

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

3. *Warrants*

As of September 30, 2014, the Company had no outstanding warrants to purchase common or preferred stock.

4. *Public Offerings of Common Stock*

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

On March 19, 2014, the Company sold 2.0 million shares of its common stock in a secondary offering at a price of $24.25 per share, providing proceeds of $45.6 million, net of expenses and underwriting discounts and commissions. The Company's sale of 1.6 million shares in the secondary offering closed on March 25, 2014 and the Company's sale of an additional 0.4 million shares as a result of the underwriters' exercise of their option to purchase additional shares closed on March 28, 2014.

Note 12. Segment and Geographic Information

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues:				
United States	$7,826	$3,742	$19,950	$8,364
Taiwan	23,795	7,576	58,684	22,615
China	4,928	9,448	15,424	23,701
	$36,549	$20,766	$94,058	$54,680

	As of the period ended	
	September 30, 2014	December 31, 2013
Long-lived assets:		
United States	$14,502	$ 9,415
Taiwan	24,843	7,192
China	16,682	16,337
	$56,027	$ 32,944

Note 13. Subsequent Events

On October 3, 2014, the Company paid down $14.0 million of borrowings of its US bank line of credit facility.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q for the period ended September 30, 2014 and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the fiscal year ended December 31, 2013 included in our Annual Report on Form 10-K. References to "Applied Optoelectronics" "we," "our" and "us" are to Applied Optoelectronics, Inc. and its subsidiaries unless otherwise specified or the context otherwise requires.

This Quarterly Report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Terminology such as "believe," "may," "might," "objective," "estimate," "continue," "anticipate," "intend," "should," "plan," "expect," "predict," "potential," "will" or the negative of these terms or other similar expressions is intended to identify forward-looking statements.

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

Overview

We are a leading, vertically integrated provider of fiber-optic access networking products. We target three networking end-markets: Cable TV Broadband, or CATV, Fiber-to-the-Home, or FTTH, and internet data centers. In designing products for our customers, we begin with the fundamental building blocks of lasers and laser components. From these foundational products, we design and manufacture optical communications products at varying levels of integration, from components, subassemblies and modules to complete turn-key equipment. We tailor our products to our customers' needs and specifications, but leverage fundamental laser technology across our different products.

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

Our vertically integrated manufacturing model provides us several advantages, including rapid product development, fast response times to customer requests and better control over product quality and manufacturing costs. The lasers we manufacture are proven to be reliable over time and highly tolerant of changes in temperature and humidity, making them well-suited to the CATV and FTTH markets where networking equipment is often installed outdoors.

We have three manufacturing sites: Sugar Land, Texas; Ningbo, China; and Taipei, Taiwan. Our research and development functions are partnered with our manufacturing locations. In our U.S. facility, we manufacture our laser chips, sub-assemblies and components. We manufacture our laser chips only within our U.S. facility, where our laser R&D team is located. In our Taiwan location, we manufacture transceivers for the FTTH and internet data center markets, which incorporate our own laser chips and components made in the U.S. In our China facility, we take advantage of lower labor costs and manufacture most of our CATV equipment systems, such as headend transmitters and outdoor nodes. Each facility conducts testing on the components, modules or subsystems it manufactures and each facility is certified to ISO 9001:2008.

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

We have grown our revenue at a 33.1% CAGR between 2009 and 2013, including 23.7% growth year-over-year from 2012 to 2013. Our revenue growth in 2013 was driven primarily by increasing revenue from our internet data center customers. Growth in the first nine months of 2014 has been driven primarily by increasing revenue from our internet data center and FTTH customers.

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

Results of Operations

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

	Three months ended September 30,				Nine months ended September 30,			
	2014		2013		2014		2013	
Revenue, net	100.0	%	100.0	%	100.0	%	100.0	%
Cost of goods sold	66.8	%	69.6	%	66.0	%	70.1	%
Gross profit	33.2	%	30.4	%	34.0	%	29.9	%
Operating expenses								
Research and development	11.5	%	10.6	%	12.5	%	11.2	%
Sales and marketing	4.4	%	5.0	%	4.7	%	5.5	%
General and administrative	12.2	%	11.7	%	12.7	%	13.3	%
Total operating expenses	28.1	%	27.4	%	29.9	%	29.9	%
Income (loss) from operations	5.1	%	3.1	%	4.1	%	0.0	%
Other income (expense)								
Interest income	0.3	%	0.1	%	0.3	%	0.1	%
Interest expense	-0.2	%	-1.6	%	-0.3	%	-1.7	%
Other expense, net	-0.7	%	0.3	%	-0.1	%	0.0	%
Total other expense	-0.6	%	-1.2	%	-0.1	%	-1.6	%
Income (loss) before income taxes	4.5	%	1.9	%	4.0	%	-1.6	%
Income taxes	-0.2	%	0.0	%	-0.2	%	0.0	%
Net income (loss)	4.3	%	1.9	%	3.8	%	-1.6	%

Comparison of Financial Results

Revenue

We generate revenue through the sale of our products to equipment providers and network operators for the CATV, FTTH and internet data center markets. We derive a significant portion of our revenue from our top ten customers, and we anticipate that we will continue to do so for the foreseeable future. We also anticipate that our revenue derived from the internet data center market will continue to increase as a percentage of our revenue as we further penetrate and extend our products into this market. The following charts provide the revenue contribution from each of the markets we served for the three and nine months ended September 30, 2014 and 2013:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
CATV	33.5 %	70.1 %	34.7 %	61.0 %
Data Center	54.9 %	15.5 %	52.7 %	24.6 %
FTTH	7.2 %	4.7 %	8.4 %	5.1 %
Other	4.5 %	9.7 %	4.2 %	9.3 %
	100.0 %	100.0 %	100.0 %	100.0 %

Three months ended September 30,		Change		Nine months ended September 30,	Change
2014	2013	Amount	%		