

Edgar Filing: AEHR TEST SYSTEMS - Form 10-Q

AEHR TEST SYSTEMS
Form 10-Q
January 13, 2009

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

/X/ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended November 30, 2008.

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: 000-22893.

AEHR TEST SYSTEMS
(Exact name of Registrant as specified in its charter)

| | |
|---|--------------------------------------|
| CALIFORNIA | 94-2424084 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 400 KATO TERRACE FREMONT, CA | 94539 |
| (Address of principal executive offices) | (Zip Code) |
| (510) 623-9400 | |
| (REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE) | |

FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE
LAST REPORT.

N/A

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 during the preceding 12 months (or for such shorter period as the
Registrant was required to file such reports), and (2) has been subject to
such filing requirements for the past 90 days.

| | | | | | |
|----------|-----|---|----|-----|-----|
| (Item 1) | YES | X | NO | --- | --- |
| (Item 2) | YES | X | NO | --- | --- |

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

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

1

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

YES _____ NO _____

Number of shares of common stock, \$0.01 par value, outstanding at December 31, 2008 was 8,449,790.

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FOR THE QUARTER ENDED NOVEMBER 30, 2008

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PART I. FINANCIAL INFORMATION

Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

AEHR TEST SYSTEMS
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (in thousands, except per share data)
 (Unaudited)

| | November 30, 2008 | May 31, 2008 |
|--|----------------------|-----------------|
| | ----- | ----- |
| | | (1) |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$11,727 | \$15,648 |
| Short-term investments | 2,003 | -- |
| Accounts receivable, net of allowances for doubtful accounts of \$226 and \$183 at November 30, 2008 and May 31, 2008, respectively | 14,811 | 10,927 |
| Inventories | 10,517 | 10,209 |
| Deferred income taxes | 2,046 | 3,043 |
| Prepaid expenses and other | 564 | 396 |
| | ----- | ----- |
| Total current assets | 41,668 | 40,223 |
| Property and equipment, net | 2,292 | 2,278 |
| Goodwill | 274 | 274 |
| Deferred income taxes | 1,900 | 1,900 |
| Other assets | 528 | 524 |
| | ----- | ----- |
| Total assets | \$46,662 | \$45,199 |
| | ===== | ===== |

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| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
|--|----------|----------|--|
| Current liabilities: | | | |
| Accounts payable | \$ 2,224 | \$ 2,981 | |
| Accrued expenses | 2,821 | 3,694 | |
| Deferred revenue | 210 | 186 | |
| | ----- | ----- | |
| Total current liabilities | 5,255 | 6,861 | |
| Income tax payable | 300 | 297 | |
| Deferred lease commitment | 315 | 269 | |
| | ----- | ----- | |
| Total liabilities | 5,870 | 7,427 | |
| | ----- | ----- | |
| Shareholders' equity: | | | |
| Common stock, \$0.01 par value: | | | |
| Issued and outstanding: 8,450 shares and | | | |
| 8,359 shares at November 30, 2008 and | | | |
| May 31, 2008, respectively | | | |
| | 85 | 84 | |
| Additional paid-in capital | 43,886 | 42,796 | |
| Accumulated other comprehensive income | 2,587 | 2,395 | |
| Accumulated deficit | (5,766) | (7,503) | |
| | ----- | ----- | |
| Total shareholders' equity | 40,792 | 37,772 | |
| | ----- | ----- | |
| Total liabilities and shareholders' equity | \$46,662 | \$45,199 | |
| | ===== | ===== | |

(1) The condensed consolidated balance sheet at May 31, 2008 has been derived from the audited consolidated financial statements at that date.

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

AEHR TEST SYSTEMS CONDENSED CONSOLIDATED STATEMENTS OF INCOME (in thousands, except per share data) (Unaudited)

| | Three Months Ended | | Six Months Ended | |
|-------------------------|--------------------|---------|------------------|----------|
| | November 30, | | November 30, | |
| | ----- | ----- | ----- | ----- |
| | 2008 | 2007 | 2008 | 2007 |
| | ----- | ----- | ----- | ----- |
| Net sales | \$9,242 | \$9,675 | \$18,932 | \$17,335 |
| Cost of sales | 4,650 | 4,791 | 9,422 | 8,270 |
| | ----- | ----- | ----- | ----- |
| Gross profit | 4,592 | 4,884 | 9,510 | 9,065 |

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| | ----- | ----- | ----- | ----- |
|--|---------|---------|----------|----------|
| Operating expenses: | | | | |
| Selling, general and administrative. | 1,830 | 1,847 | 3,915 | 3,663 |
| Research and development | 1,577 | 1,445 | 3,055 | 3,093 |
| | ----- | ----- | ----- | ----- |
| Total operating expenses | 3,407 | 3,292 | 6,970 | 6,756 |
| | ----- | ----- | ----- | ----- |
| Income from operations | 1,185 | 1,592 | 2,540 | 2,309 |
| Interest income | 47 | 83 | 110 | 158 |
| Other income (expense), net. | 384 | (110) | 377 | (108) |
| | ----- | ----- | ----- | ----- |
| Income before income tax expense | 1,616 | 1,565 | 3,027 | 2,359 |
| Income tax expense | 744 | 199 | 1,290 | 214 |
| | ----- | ----- | ----- | ----- |
| Net income | \$ 872 | \$1,366 | \$ 1,737 | \$ 2,145 |
| | ===== | ===== | ===== | ===== |
| Net income per share - basic | \$ 0.10 | \$ 0.17 | \$ 0.21 | \$ 0.27 |
| Net income per share - diluted | \$ 0.10 | \$ 0.16 | \$ 0.20 | \$ 0.26 |
| Shares used in per share calculations: | | | | |
| Basic. | 8,426 | 7,906 | 8,411 | 7,866 |
| Diluted. | 8,447 | 8,418 | 8,600 | 8,359 |

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

AEHR TEST SYSTEMS
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

| | Six Months Ended November 30, | |
|--|----------------------------------|---------|
| | ----- | ----- |
| | 2008 | 2007 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net income..... | \$ 1,737 | \$2,145 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Stock compensation expense..... | 616 | 396 |
| Provision for doubtful accounts..... | 55 | -- |
| Loss on disposal of Property and equipment.. | -- | 3 |
| Depreciation and amortization..... | 233 | 232 |

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| | | |
|---|----------|---------|
| Deferred income taxes..... | 997 | -- |
| Changes in operating assets and liabilities: | | |
| Accounts receivable..... | (3,875) | (4,723) |
| Inventories..... | (283) | (936) |
| Deferred lease commitment..... | 46 | (45) |
| Accounts payable..... | (757) | (913) |
| Income tax payable..... | 4 | -- |
| Accrued expenses and deferred revenue..... | (850) | 124 |
| Prepaid expenses and other..... | (168) | (38) |
| | ----- | ----- |
| Net cash used in operating activities..... | (2,245) | (3,755) |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Purchase of investments..... | (2,000) | (500) |
| Proceeds from sales and maturity of investments..... | -- | 2,534 |
| Purchase of property and equipment..... | (246) | (143) |
| Increase in other assets..... | -- | 14 |
| | ----- | ----- |
| Net cash (used in) provided by investing activities..... | (2,246) | 1,905 |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock and exercise of stock options..... | 450 | 815 |
| | ----- | ----- |
| Net cash provided by financing activities..... | 450 | 815 |
| | ----- | ----- |
| Effect of exchange rates on cash..... | 120 | 458 |
| | ----- | ----- |
| Net decrease in cash and cash equivalents..... | (3,921) | (577) |
| Cash and cash equivalents, beginning of period.. | 15,648 | 6,564 |
| | ----- | ----- |
| Cash and cash equivalents, end of period..... | \$11,727 | \$5,987 |
| | ===== | ===== |

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

AEHR TEST SYSTEMS
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial information has been prepared by Aehr Test Systems, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and therefore

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does not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America.

In the opinion of management, the unaudited condensed consolidated financial statements for the interim periods presented reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the condensed consolidated financial position and results of operations as of and for such periods indicated. These condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2008. Results for the interim periods presented herein are not necessarily indicative of results which may be reported for any other interim period or for the entire fiscal year.

PRINCIPLES OF CONSOLIDATION. The consolidated financial statements include the accounts of Aehr Test Systems and its subsidiaries (collectively, the "Company," "we," "us," and "our"). All significant intercompany balances have been eliminated in consolidation.

ACCOUNTING ESTIMATES. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from those estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

2. STOCK-BASED COMPENSATION

The Company accounts for stock options and employee stock purchase plan ("ESPP") shares under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)") which requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, 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. All of the Company's stock compensation is accounted for as an equity instrument. The Company's condensed consolidated financial statements for the three and six months ended November 30, 2008 and 2007 reflect the impact of SFAS No. 123(R). See Notes 9 and 10 in the Company's Annual Report on Form 10-K for fiscal 2008 filed on August 29, 2008 for further information regarding the stock option plan and the employee stock purchase plan.

The following table summarizes compensation costs related to the Company's stock-based compensation for the three and six months ended November 30, 2008 and 2007, respectively (in thousands, except per share data):

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| | Three Months Ended November 30, | | Six Months Ended November 30, | |
|---|------------------------------------|--------|----------------------------------|--------|
| | 2008 | 2007 | 2008 | 2007 |
| Stock-based compensation in the form of employee stock options and ESPP shares, included in: | | | | |
| Cost of sales | \$ 42 | \$ 20 | \$ 81 | \$ 31 |
| Selling, general and administrative | 178 | 116 | 333 | 229 |
| Research and development | 110 | 67 | 202 | 136 |
| | ----- | ----- | ----- | ----- |
| Total stock-based compensation | 330 | 203 | 616 | 396 |
| Tax effect on stock-based compensation | (132) | (4) | (255) | (8) |
| | ----- | ----- | ----- | ----- |
| Net effect on net income | \$198 | \$199 | \$361 | \$388 |
| | ===== | ===== | ===== | ===== |
| Effect on net income per share: | | | | |
| Basic | \$0.02 | \$0.03 | \$0.04 | \$0.05 |
| Diluted | \$0.02 | \$0.02 | \$0.04 | \$0.05 |

Stock-based compensation expense of \$14,000 and \$25,000 for the three and six months ended November 30, 2008, respectively, and \$19,000 and \$40,000 for the three and six months ended November 30, 2007, respectively, was capitalized to inventory and was not reflected in the above table. As of November 30, 2008, stock-based compensation costs of \$56,000 are capitalized as part of inventory.

During the three months ended November 30, 2008 and 2007, the Company recorded stock-based compensation related to stock options of \$284,000 and \$168,000, respectively. During the six months ended November 30, 2008 and 2007, the Company recorded stock-based compensation related to stock options of \$535,000 and \$326,000, respectively.

As of November 30, 2008, the total compensation cost related to unvested stock-based awards under the Company's 1996 Stock Option Plan and 2006 Equity Incentive Plan, but not yet recognized, was approximately \$3,160,000, which is net of estimated forfeitures of \$64,000. This cost will be amortized on a straight-line basis over a weighted average period of approximately 3.14 years.

During the three months ended November 30, 2008 and 2007, the Company recorded stock-based compensation related to its ESPP of \$46,000 and \$35,000, respectively. During the six months ended November 30, 2008 and 2007, the Company recorded stock-based compensation related to our ESPP of \$81,000 and \$70,000, respectively.

As of November 30, 2008, the total compensation cost related to options to purchase the Company's common shares under the ESPP but not yet recognized was approximately \$158,000. This cost will be amortized on a straight-line basis over a weighted average period of approximately 1.3 years.

Valuation Assumptions

Valuation and Amortization Method. The Company estimates the fair value of stock options granted using the Black-Scholes option valuation model and a single option award approach for options granted after June 1, 2006. The multiple option approach has been used for all options granted prior to June 1, 2006. The fair value under the single option approach is amortized on a

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straight-line basis over the requisite service period of the awards, which is generally the vesting period. The fair value under the multiple option approach is amortized on a weighted basis over the requisite service period of the awards, which is generally the vesting period.

Expected Term. The Company's expected term represents the period that the Company's stock-based awards are expected to be outstanding and was determined based on historical experience, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future

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employee behavior as evidenced by changes to the terms of the Company's stock-based awards.

Expected Volatility. Volatility is a measure of the amounts by which a financial variable such as stock price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company uses the historical volatility for the past five years, which matches the term of most of the option grants, to estimate expected volatility. Volatility for each of the ESPP's four time periods of six months, twelve months, eighteen months, and twenty-four months is calculated separately and included in the overall stock-based compensation cost recorded.

Dividends. The Company has never paid any cash dividends on its common stock and we do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes option valuation model.

Risk-Free Interest Rate. The Company bases the risk-free interest rate used in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with a remaining term equivalent to the expected term of the stock awards including the ESPP.

Estimated Forfeitures. When estimating forfeitures, the Company considers voluntary termination behavior as well as analysis of actual option forfeitures.

Fair Value. The fair values of the Company's stock options granted to employees and ESPP shares for the three and six months ended November 30, 2008 and 2007 were estimated using the following weighted average assumptions in the Black-Scholes option valuation model consistent with the provisions of SFAS No. 123(R) and Securities and Exchange Commission Staff Accounting Bulletin No. 107.

The fair value of our stock options granted to employees for the three and six months ended November 30, 2008 and 2007, respectively, was estimated using the following weighted-average assumptions:

| Three months ended November 30, | | Six Months Ended November 30, | |
|------------------------------------|---------------|----------------------------------|---------------|
| ----- 2008 | 2007 ----- | ----- 2008 | 2007 ----- |

Option Plan Shares

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| | | | | |
|---|--------|--------|--------|--------|
| Expected Term (in years)..... | 5 | 5 | 5 | 5 |
| Volatility..... | 0.76 | 0.72 | 0.74 | 0.74 |
| Expected Dividend..... | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Risk-free Interest Rates..... | 2.51% | 4.02% | 3.00% | 4.70% |
| Estimated Forfeiture Rate..... | 2% | 4% | 2% | 4% |
| Weighted Average Grant Date Fair Value..... | \$1.43 | \$4.53 | \$3.71 | \$3.91 |

The fair value of our ESPP shares for the three and six months ended August 31, 2008 and 2007, respectively, was estimated using the following weighted-average assumptions:

| | Three months ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-----------|
| | November 30, | | November 30, | |
| | ----- 2008 | 2007 | ----- 2008 | 2007 |
| Employee Stock Purchase Plan Shares | | | | |
| Expected Term (in years)..... | 0.5-2.0 | 0.5-2.0 | 0.5-2.0 | 0.5-2.0 |
| Volatility..... | 0.64-0.88 | 0.43-0.61 | 0.62-0.88 | 0.43-0.69 |
| Expected Dividend..... | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Risk-free Interest Rates..... | 1.2%-1.6% | 4.0%-4.7% | 1.2%-2.6% | 4.0%-4.9% |
| Estimated Forfeiture Rate..... | 0% | 4% | 0% | 4% |
| Weighted Average Grant Date Fair Value.... | \$1.47 | \$2.10 | \$1.72 | \$2.17 |

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The following table summarizes the stock option transactions during the three and six months ended November 30, 2008 (in thousands, except per share data):

| | Outstanding Options | | | |
|--------------------------------|------------------------------|---------------------------------|---|--|
| | ----- Available Shares | ----- Number of Shares | ----- Weighted Average Exercise Price | ----- Aggregate Intrinsic Value |
| Balances, May 31, 2008..... | 350 | 1,266 | \$5.05 | \$4,632 |
| Options granted..... | (268) | 268 | \$10.03 | |
| Options terminated..... | 2 | (2) | \$5.17 | |
| Options exercised..... | -- | (44) | \$4.35 | |
| Balances, August 31, 2008..... | ----- 84 | ----- 1,488 | ----- \$5.97 | ----- \$604 |
| Additional shares reserved.. | 600 | -- | | |
| Options granted..... | (279) | 279 | \$2.27 | |
| Options terminated..... | 5 | (5) | \$4.72 | |

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| | | | | |
|---|-------|-------|--------|----|
| Balances, November 30, 2008... | 410 | 1,762 | \$5.38 | -- |
| | ===== | ===== | | |
| Options exercisable and expected to be exercisable at November 30, 2008 | | 1,727 | \$5.38 | -- |
| | | ===== | | |

The options outstanding and exercisable at November 30, 2008 were in the following exercise price ranges (in thousands, except per share data):

| Range of Exercise Prices | Options Outstanding at November 30, 2008 | | | Options Exercisable at November 30, 2008 | | | |
|--------------------------|--|---|---------------------------------|--|---------------------------------|---|---------------------------|
| | Number Outstanding Shares | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value |
| \$2.25-\$3.63 | 696 | 3.68 | \$2.76 | 384 | \$3.10 | 2.80 | |
| \$3.66-\$4.08 | 139 | 2.00 | \$3.92 | 138 | \$3.92 | 1.98 | |
| \$4.35-\$4.60 | 53 | 1.04 | \$4.45 | 53 | \$4.45 | 1.04 | |
| \$5.91-\$7.00 | 419 | 3.49 | \$6.11 | 166 | \$6.11 | 3.30 | |
| \$7.28-\$10.93 | 455 | 4.49 | \$9.29 | 133 | \$8.60 | 4.43 | |
| \$2.25-\$10.93 | 1,762 | 3.63 | \$5.38 | 874 | \$4.72 | 2.91 | -- |
| | ===== | | | ===== | | | |

The total intrinsic value of options exercised for the three and six months ended November 30, 2008 was \$0 and \$219,000, respectively. The weighted average remaining contractual life of the options exercisable and expected to be exercisable at November 30, 2008 was 3.6 years.

3. EARNINGS PER SHARE

Earnings per share is computed based on the weighted average number of common and common equivalent shares (common stock options and ESPP shares) outstanding, when dilutive, during each period using the treasury stock method.

| Three Months Ended November 30, | | Six Months Ended November 30, | |
|---------------------------------|------|-------------------------------|------|
| 2008 | 2007 | 2008 | 2007 |
| | | | |

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(in thousands, except per share amounts)

| | | | | |
|--|---------|---------|---------|---------|
| Numerator: Net income | \$ 872 | \$1,366 | \$1,737 | \$2,145 |
| ----- | | | | |
| Denominator for basic net income per share: | | | | |
| Weighted-average shares outstanding | 8,426 | 7,906 | 8,411 | 7,866 |
| ----- | | | | |
| Shares used in basic per share calculation. | 8,426 | 7,906 | 8,411 | 7,866 |
| ----- | | | | |
| Effect of dilutive securities..... | 21 | 512 | 189 | 493 |
| ----- | | | | |
| Denominator for diluted net income per share..... | 8,447 | 8,418 | 8,600 | 8,359 |
| ----- | | | | |
| Basic net income per share..... | \$ 0.10 | \$ 0.17 | \$ 0.21 | \$ 0.27 |
| ===== | | | | |
| Diluted net income per share..... | \$ 0.10 | \$ 0.16 | \$ 0.20 | \$ 0.26 |
| ===== | | | | |

Stock options to purchase 1,272,000 and 169,000 shares of common stock were outstanding on November 30, 2008 and 2007, respectively, but not included in the computation of diluted income per share, because the inclusion of such shares would be anti-dilutive.

4. CASH EQUIVALENTS AND INVESTMENTS

On June 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157") which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. SFAS No. 157 applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, for which application has been deferred for one year. In February 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-2 defers the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. The adoption of SFAS No. 157 did not have a material impact on our consolidated financial statements.

SFAS No. 157 includes a fair value hierarchy that is intended to increase the consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The fair value hierarchy consists of the following three levels:

Level 1 - instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets.

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Level 2 - instrument valuations are obtained from readily-available pricing sources for comparable instruments.

Level 3 - instrument valuations are obtained without observable market values and require a high level of judgment to determine the fair value.

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

| | Balance as of November 30, 2008 | Level 1 | Level 2 |
|------------------------------------|------------------------------------|---------|---------|
| | ----- | ----- | ----- |
| Money market funds..... | \$ 8,115 | \$8,115 | \$ -- |
| United States government agency... | 2,003 | -- | 2,003 |
| | ----- | ----- | ----- |
| | \$10,118 | \$8,115 | \$2,003 |
| | ===== | ===== | ===== |
| | ----- | ----- | ----- |
| Liabilities..... | \$ -- | \$ -- | \$ -- |
| | ===== | ===== | ===== |

As of November 30, 2008, the Company did not have any assets or liabilities without observable market values that would require a high level of judgment to determine fair value (Level 3 assets).

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115," (SFAS No. 159) which is effective for fiscal years beginning after November 15, 2007. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. Unrealized gains and losses on items for which the fair value option is elected would be reported in earnings. On June 1, 2008, the Company adopted SFAS No. 159 and has elected not to measure any additional financial instruments and other items at fair value.

5. INVENTORIES

Inventories are comprised of the following (in thousands):

| | |
|----------------------|-----------------|
| November 30, 2008 | May 31, 2008 |
|----------------------|-----------------|

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| | | |
|---------------------------------------|----------|----------|
| Raw materials and sub-assemblies..... | \$ 4,963 | \$ 5,482 |
| Work in process..... | 5,402 | 4,462 |
| Finished goods..... | 152 | 265 |
| | ----- | ----- |
| | \$10,517 | \$10,209 |
| | ===== | ===== |

6. SEGMENT INFORMATION

The Company operates in one reportable segment: the design, manufacture and marketing of advanced test and burn-in products to the semiconductor manufacturing industry.

The following presents information about the Company's operations in different geographic areas (in thousands):

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| | United States | Asia | Europe | Adjust- ments | Total |
|---|------------------|---------|--------|------------------|----------|
| | ----- | ----- | ----- | ----- | ----- |
| Three months ended November 30, 2008: | | | | | |
| Net sales..... | \$ 9,593 | \$1,637 | \$ 234 | \$ (2,222) | \$ 9,242 |
| Portion of U.S. net sales from export sales, including sales to subsidiaries..... | 8,870 | -- | -- | -- | 8,870 |
| Income from operations..... | 1,104 | 60 | 17 | 4 | 1,185 |
| Identifiable assets..... | 54,563 | 5,772 | 1,049 | (14,722) | 46,662 |
| Property and equipment, net..... | 2,205 | 75 | 12 | -- | 2,292 |
| Six months ended November 30, 2008: | | | | | |
| Net sales..... | \$18,720 | \$4,495 | \$ 479 | \$ (4,762) | \$18,932 |
| Portion of U.S. net sales from export sales, including sales to subsidiaries..... | 13,494 | -- | -- | -- | 13,494 |
| Income from operations..... | 2,256 | 153 | 15 | 116 | 2,540 |
| Identifiable assets..... | 54,563 | 5,772 | 1,049 | (14,722) | 46,662 |
| Property and equipment, net..... | 2,205 | 75 | 12 | -- | 2,292 |
| Three months ended November 30, 2007: | | | | | |
| Net sales..... | \$ 7,760 | \$5,802 | \$ 31 | \$ (3,918) | \$ 9,675 |
| Portion of U.S. net sales from export sales, including sales to subsidiaries..... | 4,054 | -- | -- | -- | 4,054 |
| Income (loss) from operations..... | 352 | 1,309 | (171) | 102 | 1,592 |
| Identifiable assets..... | 38,675 | 9,609 | 778 | (17,126) | 31,936 |
| Property and equipment, net..... | 1,527 | 69 | 9 | -- | 1,605 |
| Six months ended November 30, 2007: | | | | | |
| Net sales..... | \$15,189 | \$7,518 | \$ 99 | \$ (5,471) | \$17,335 |

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| | | | | | |
|------------------------------------|--------|-------|-------|----------|--------|
| Portion of U.S. net sales | | | | | |
| from export sales, including sales | | | | | |
| to subsidiaries..... | 6,957 | -- | -- | -- | 6,957 |
| Income (loss) from operations..... | 1,160 | 1,425 | (290) | 14 | 2,309 |
| Identifiable assets..... | 38,675 | 9,609 | 778 | (17,126) | 31,936 |
| Property and equipment, net..... | 1,527 | 69 | 9 | -- | 1,605 |

The Company's foreign operations are primarily those of its Japanese and German subsidiaries. Substantially all of the sales of the subsidiaries are made to unaffiliated Japanese or European customers. Net sales and income (loss) from operations from outside the United States include the operating results of Aehr Test Systems Japan K.K. and Aehr Test Systems GmbH. Adjustments consist of intercompany eliminations. Identifiable assets are all assets identified with operations in each geographic area.

Sales to the Company's five largest customers accounted for approximately 99.4% and 96.5% of its net sales in the three and six months ended November 30, 2008, respectively. One customer accounted for approximately 92.8% and 90.5% of the Company's net sales in the three and six months ended November 30, 2008, respectively. Sales to the Company's five largest customers accounted for approximately 99.2% and 98.3% of its net sales in the three and six months ended November 30, 2007, respectively. One customer accounted for approximately 91.3% and 83.6% of the Company's net sales in the three and six months ended November 30, 2007, respectively.

7. PRODUCT WARRANTIES

The Company provides for the estimated cost of product warranties at the time the products are shipped. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, the Company's warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from the Company's estimates, revisions to the estimated warranty liability would be required.

Following is a summary of changes in the Company's liability for product warranties during the three and six months ended November 30, 2008 and 2007 (in thousands):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------|------------------|-------|
| | November 30, | | November 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Balance at the beginning of the period.... | \$428 | \$177 | \$387 | \$153 |
| Accruals for warranties issued | | | | |
| during the period..... | 81 | 287 | 298 | 361 |
| Reversals of warranties issued | | | | |
| during the period..... | -- | -- | -- | -- |
| Settlement made during the period | | | | |
| (in cash or in kind)..... | (248) | (193) | (424) | (243) |

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| | | | | |
|---------------------------------------|-------|-------|-------|-------|
| Balance at the end of the period..... | \$261 | \$271 | \$261 | \$271 |
| | ===== | ===== | ===== | ===== |

The accrued warranty balance is included in accrued expenses on the accompanying condensed consolidated balance sheets.

8. OTHER COMPREHENSIVE INCOME

Other comprehensive income, net of tax is comprised of the following (in thousands):

| | Three Months Ended November 30, | | Six Months Ended November 30, | |
|--|------------------------------------|---------|----------------------------------|---------|
| | 2008 | 2007 | 2008 | 2007 |
| | ----- | ----- | ----- | ----- |
| Net income..... | \$ 872 | \$1,366 | \$1,737 | \$2,145 |
| Foreign currency translation adjustments expense..... | 409 | 334 | 189 | 438 |
| Unrealized holding gains arising during period..... | 2 | 2 | 3 | 2 |
| | ----- | ----- | ----- | ----- |
| Comprehensive income..... | \$1,283 | \$1,702 | \$1,929 | \$2,585 |
| | ===== | ===== | ===== | ===== |

9. INCOME TAXES

On June 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Upon adoption of FIN No. 48 on June 1, 2007, the Company recognized a cumulative effect adjustment of \$127,000, decreasing its income tax liability for unrecognized tax benefits, and decreasing the May 31, 2007 accumulated deficit balance. The Company does not expect any material change in its unrecognized tax benefits over the next twelve months. In accordance with FIN No. 48, the Company recognizes interest and penalties related to unrecognized tax benefits as a component of income taxes.

For the three and six months ended November 30, 2008, the Company had recorded tax expenses of \$744,000 and \$1,290,000, respectively. For the three and six months ended November 30, 2007, the Company had recorded tax expenses of \$199,000 and \$214,000, respectively.

Although the Company files U.S. federal, various state, and foreign tax returns, the Company's only major tax jurisdictions are the United States, California, Germany and Japan. Tax years 1993 - 2007 remain subject to examination by the appropriate governmental agencies due to tax loss carryovers from those years.

10. EMPLOYEE BENEFIT PLANS

In addition to the Company's stock options and employee stock purchase plan discussed in Notes 9 and 10 in the Company's 2008 Annual Report on Form 10-K, the Company maintains an equity incentive plan and employee benefit plans under which its equity securities are authorized for issuance to the Company's employees, directors and consultants.

The purpose of these plans is to provide equity ownership and compensation opportunities in the Company by attracting and retaining the services of qualified and talented persons to serve as employees, directors and/or consultants of the Company. Those plans were approved by the Company's shareholders.

In October 2006, the Company's 2006 Equity Incentive Plan and the 2006 Employee Stock Purchase Plan ("2006 Plans") were approved by the Company's shareholders. The 2006 Plans replace the Company's Amended and Restated 1996 Stock Option Plan, which would otherwise have expired in 2006, and the Company's 1997 Employee Stock Purchase Plan, which would otherwise have expired in 2007. The Amended and Restated 1996 Stock Option Plan will continue to govern awards previously granted under that plan.

As of November 30, 2008, out of the 2,172,000 shares authorized for grant under the 1996 Stock Option Plan and 2006 Equity Incentive Plan, approximately 1,762,000 shares had been granted. As of November 30, 2008, 73,000 shares had been issued from the 200,000 shares authorized for grant under the 2006 Employee Stock Purchase Plan.

11. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2008, the FASB issued FASB Staff Position No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active" ("FSP 157-3"). FSP 157-3 clarifies the application of SFAS No. 157 in a market that is not active and it is effective upon the issuance date. The application of FSP 157-3 did not have a material impact on the Company's consolidated financial position and results of operations.

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

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes that appear elsewhere in this document and with our Annual Report on Form 10-K for the fiscal year ended May 31, 2008 and the consolidated financial statements and notes thereto.

In addition to historical information, this report contains 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. These statements typically may be identified by the use of forward-looking words or phrases such as "believe," "expect," "intend," "anticipate," "should," "planned," "estimated," and "potential," among others and include, but are not limited to, statements concerning our expectations regarding our operations, business, strategies, prospects, revenues, expenses, costs and

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resources. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those anticipated results or other expectations reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report and other factors beyond our control, and in particular, the risks discussed in "Part II, Item 1A. Risk Factors" and those discussed in other documents we file with the Securities and Exchange Commission. All forward-looking statements included in this document are based on our current expectations, and we

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undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

CRITICAL ACCOUNTING POLICIES

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to customer programs and incentives, product returns, bad debts, inventories, investments, intangible assets, income taxes, financing operations, warranty obligations, long-term service contracts, and contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. For a discussion of the critical accounting policies, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2008.

RESULTS OF OPERATIONS

The following table sets forth items in the Company's unaudited condensed consolidated statements of income as a percentage of net sales for the periods indicated.

| | Three Months Ended November 30, | | Six Months Ended November 30, | |
|------------------------|------------------------------------|---------|----------------------------------|---------|
| | 2008 | 2007 | 2008 | 2007 |
| Net sales. | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| Cost of sales. | 50.3 | 49.5 | 49.8 | 47.7 |

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| | | | | |
|---|-------|--------|-------|--------|
| Gross profit | 49.7 | 50.5 | 50.2 | 52.3 |
| Operating expenses: | | | | |
| Selling, general and administrative | 19.8 | 19.1 | 20.7 | 21.1 |
| Research and development | 17.1 | 14.9 | 16.1 | 17.8 |
| Total operating expenses | 36.9 | 34.0 | 36.8 | 38.9 |
| Income from operations | 12.8 | 16.5 | 13.4 | 13.4 |
| Interest income | 0.5 | 0.8 | 0.6 | 0.9 |
| Other income (expense), net | 4.2 | (1.1) | 2.0 | (0.7) |
| Income before income tax expense | 17.5 | 16.2 | 16.0 | 13.6 |
| Income tax expense | 8.1 | 2.1 | 6.8 | 1.2 |
| Net income | 9.4 % | 14.1 % | 9.2 % | 12.4 % |

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THREE MONTHS ENDED NOVEMBER 30, 2008 COMPARED TO THREE MONTHS ENDED NOVEMBER 30, 2007

NET SALES. Net sales decreased to \$9.2 million for the three months ended November 30, 2008 from \$9.7 million for the three months ended November 30, 2007, a decrease of 4.5%. The decrease in net sales for the three months ended November 30, 2008 resulted primarily from decreases in net sales of the Company's wafer level products and MAX monitored burn-in products. Net sales of the Company's wafer level products for the three months ended November 30, 2008 were \$8.5 million, and decreased approximately \$273,000 from the three months ended November 30, 2007. Net sales of the Company's MAX monitored burn-in products for the three months ended November 30, 2008 were \$629,000, and decreased approximately \$191,000 from the three months ended November 30, 2007. The Company is not expecting a meaningful improvement in this difficult operating environment until the second half of calendar 2009 at the earliest.

GROSS PROFIT. Gross profit consists of net sales less cost of sales. Cost of sales consists primarily of the cost of materials, assembly and test costs, and overhead from operations. Gross profit decreased to \$4.6 million for the three months ended November 30, 2008 from \$4.9 million for the three months ended November 30, 2007, a decrease of 6.0%. As a percentage of net sales, gross profit margin decreased to 49.7% for the three months ended November 30, 2008 from 50.5% for the three months ended November 30, 2007. The decrease in gross profit margin was primarily the result of the increased costs associated with ramping up production of WaferPak contactors.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative ("SG&A") expenses consist primarily of salaries and related costs of employees, commission expenses to independent sales representatives, product promotion and other professional services. There was no significant difference in the SG&A expenses, each \$1.8 million, between the three months ended November 30, 2008 and the three months ended November 30, 2007. As a percentage of net sales, SG&A expenses slightly increased to 19.8% for the three months ended November 30, 2008 from 19.1% for the three months ended

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November 30, 2007, resulting from lower net sales.

RESEARCH AND DEVELOPMENT. Research and development ("R&D") expenses consist primarily of salaries and related costs of employees engaged in ongoing research, design and development activities, costs of engineering materials and supplies, and professional consulting expenses. R&D expenses increased to \$1.6 million for the three months ended November 30, 2008 from \$1.4 million for the three months ended November 30, 2007, an increase of 9.1%. This increase was primarily due to an increase in project material expenses. As a percentage of net sales, R&D expenses increased to 17.1% for the three months ended November 30, 2008 from 14.9% for the three months ended November 30, 2007, resulting from lower net sales.

INTEREST INCOME. Interest income decreased to \$47,000 for the three months ended November 30, 2008 from \$83,000 for the three months ended November 30, 2007. The decrease in net interest income for the three months ended November 30, 2008 was primarily related to lower interest rates.

OTHER INCOME (EXPENSE), NET. Other income (expense), net increased to \$384,000 for the three months ended November 30, 2008 from (\$110,000) for the three months ended November 30, 2007. This increase was primarily attributable to foreign exchange gains on settlement of transactions in our Japan subsidiary.

INCOME TAX EXPENSE. Income tax expense was \$744,000 for the three months ended November 30, 2008 and \$199,000 for the three months ended November 30, 2007. A low effective tax rate was recognized for the three months ended November 30, 2007 as the Company maintained a valuation allowance and recorded tax expense at the alternative minimum tax rate. During the fiscal year ended May 31, 2008 a partial release of the valuation allowance was made based upon the Company's current level of profitability and the level of forecasted future earnings. The second quarter of fiscal 2009 reflects a significantly

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higher tax rate than the same period of the prior year as the Company now expects to accrue tax at close to the statutory rates for the countries in which it generates income.

SIX MONTHS ENDED NOVEMBER 30, 2008 COMPARED TO SIX MONTHS ENDED NOVEMBER 30, 2007

NET SALES. Net sales increased to \$18.9 million for the six months ended November 30, 2008 from \$17.3 million for the six months ended November 30, 2007, an increase of 9.2%. The increase in net sales for the six months ended November 30, 2008 resulted primarily from an increase in net sales of the Company's wafer level products, partially offset by a decrease in sales of the Company's MAX monitored burn-in products. Net sales of the Company's wafer level products for the six months ended November 30, 2008 were \$17.0 million, and increased approximately \$2.6 million from the six months ended November 30, 2007. Net sales of the Company's MAX monitored burn-in products for the six months ended November 30, 2008 were \$1.6 million, and decreased approximately \$962,000 from the six months ended November 30, 2007.

GROSS PROFIT. Gross profit increased to \$9.5 million for the six months ended November 30, 2008 from \$9.1 million for the six months ended November 30, 2007, an increase of 4.9%. Gross profit margin decreased to 50.2% for the six months ended November 30, 2008 from 52.3% for the six months ended November 30, 2007. The decrease in gross profit margin was primarily the

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result of the increased costs associated with ramping up production of WaferPak contactors.

SELLING, GENERAL AND ADMINISTRATIVE. SG&A expenses increased to \$3.9 million for the six months ended November 30, 2008 from \$3.7 million for the six months ended November 30, 2007, an increase of 6.9%. The increases in SG&A expenses were primarily due to increases in employment related expenses of approximately \$172,000. As a percentage of net sales, SG&A expenses decreased to 20.7% for the six months ended November 30, 2008 from 21.1% for the six months ended November 30, 2007, reflecting higher net sales.

RESEARCH AND DEVELOPMENT. R&D expenses were \$3.1 million for the six months ended November 30, 2008, flat with the same period of the prior year. As a percentage of net sales, R&D expenses decreased to 16.1% for the six months ended November 30, 2008 from 17.8% for the six months ended November 30, 2007, reflecting higher net sales.

INTEREST INCOME. Interest income decreased to \$110,000 for the six months ended November 30, 2008 from \$158,000 for the six months ended November 30, 2007, a decrease of 30.4%. The decrease in net interest income for the six months ended November 30, 2008 was primarily related to lower interest rates.

OTHER INCOME (EXPENSE), NET. Other income (expense), net increased to \$377,000 for the six months ended November 30, 2008 from (\$108,000) for the six months ended November 30, 2007. The increase in other income (expense), net was primarily attributable to foreign exchange gains on settlement of transactions in our Japan subsidiary.

INCOME TAX EXPENSE. Income tax expense increased to \$1.3 million for the six months ended November 30, 2008, from \$214,000 for the six months ended November 30, 2007. A low effective tax rate was recognized for the six months ended November 30, 2007 as the Company maintained a valuation allowance and recorded tax expense at the alternative minimum tax rate. During the fiscal year ended May 31, 2008 a partial release of the valuation allowance was made based upon the Company's current level of profitability and the level of forecasted future earnings. The six-month period of fiscal 2009 reflects a significantly higher tax rate than the same period of the prior year as the Company now expects to accrue tax at close to the statutory rates for the countries in which it generates income.

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LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities was approximately \$2.2 million for the six months ended November 30, 2008 and \$3.8 million for the six months ended November 30, 2007. For the six months ended November 30, 2008, net cash used in operating activities was primarily driven by an increase in accounts receivable of \$3.9 million, partially offset by net income of \$1.7 million. The increase in accounts receivable for the six-month period was primarily due to a delay in collection of receivables from a large multinational customer. For the six months ended November 30, 2007, net cash used in operating activities was primarily driven by increases in accounts receivable of \$4.7 million and inventories of \$936,000, and a decrease in accounts payable \$913,000, partially offset by net income of \$2.1 million, stock compensation expense of \$396,000, and depreciation and amortization of \$232,000. The increase in accounts receivable for the six-month period was primarily attributable to the higher level of sales, as well as an increase in the level of receivables in Japan, which typically have longer payment terms. Inventories increased primarily due to the ramp up in production resulting from the strong growth in FOX-1 backlog. The decrease in accounts payable was

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primarily a matter of timing, as the Company received a proportionately higher than normal amount of goods early in this six-month period.

Net cash used in investing activities was approximately \$2.2 million for the six months ended November 30, 2008 and net cash provided by investing activities was approximately \$1.9 million for the six months ended November 30, 2007. The net cash used in investing activities during the six months ended November 30, 2008 was primarily due to the purchase of investments. The net cash provided by investing activities during the six months ended November 30, 2007 was primarily attributable to proceeds from sales and maturities of investments.

Financing activities provided cash of approximately \$450,000 for the six months ended November 30, 2008 and approximately \$815,000 for the six months ended November 30, 2007, respectively. Net cash provided by financing activities during the six months ended November 30, 2008 and 2007 was primarily due to proceeds from issuance of common stock from the exercise of stock options.

As of November 30, 2008, the Company had working capital of \$36.4 million. Working capital consists of cash and cash equivalents, short-term investments, accounts receivable, inventory and other current assets, less current liabilities.

The Company announced in August 1998 that its board of directors had authorized the repurchase of up to 1,000,000 shares of its outstanding common shares. The Company may repurchase the shares in the open market or in privately negotiated transactions, from time to time, subject to market conditions. The number of shares of common stock actually acquired by the Company will depend on subsequent developments and corporate needs, and the repurchase program may be interrupted or discontinued at any time. Any such repurchase of shares, if consummated, may use a portion of the Company's working capital. As of May 31, 2006, the Company had repurchased 523,700 shares at an average price of \$3.95. Shares repurchased by the Company are cancelled. The Company has not repurchased any of its outstanding common stock since May 31, 2006.

The Company leases most of its manufacturing and office space under operating leases. The term of the Company's current lease ends on June 30, 2015 for its United States manufacturing and office facilities. Under the lease agreement, the Company is responsible for payments of utilities, taxes and insurance.

From time to time, the Company evaluates potential acquisitions of businesses, products or technologies that complement the Company's business. Any such transactions, if consummated, may use a portion of the Company's working capital or require the issuance of equity. The Company has no present

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understandings, commitments or agreements with respect to any material acquisitions.

The Company anticipates that the existing cash balances together with cash provided by operations, if any, are adequate to meet its working capital and capital equipment requirements through calendar year 2009. After calendar year 2009, depending on its rate of growth and profitability, the Company may require additional equity or debt financing to meet its working capital requirements or capital equipment needs. There can be no assurance that additional financing will be available when required, or, if available, that such financing can be obtained on terms satisfactory to the Company.

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OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any off-balance sheet financing arrangements and has not established any variable interest entities.

OVERVIEW OF CONTRACTUAL OBLIGATIONS

There have been no material changes in the composition, magnitude or other key characteristics of the Company's contractual obligations or other commitments as disclosed in the Company's Annual Report on Form 10-K for the year ended May 31, 2008.

RECENT ACCOUNTING PRONOUNCEMENTS

In October 2008, the FASB issued FASB Staff Position No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active" ("FSP 157-3"). FSP 157-3 clarifies the application of SFAS No. 157 in a market that is not active and it is effective upon the issuance date. The application of FSP 157-3 did not have a material impact on the Company's consolidated financial position and results of operations.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company considered the provisions of Financial Reporting Release No. 48, "Disclosures of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments, and Disclosures of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Commodity Instruments." The Company had no holdings of derivative financial or commodity instruments at November 30, 2008.

The Company is exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. The Company invests excess cash in a managed portfolio of corporate and government bond instruments with maturities of 18 months or less. The Company does not use any financial instruments for speculative or trading purposes. Fluctuations in interest rates would not have a material effect on the Company's financial position, results of operations or cash flows.

A majority of the Company's revenue and capital spending is transacted in U.S. dollars. The Company, however, enters into transactions in other currencies, primarily Japanese Yen. Substantially all sales to Japanese customers are denominated in Yen. Since the price is determined at the time a purchase order is accepted, the Company is exposed to the risks of fluctuations in the Yen-U.S. dollar exchange rate during the lengthy period from purchase order to ultimate payment. This exchange rate risk is partially offset to the extent that the Company's Japanese subsidiary incurs expenses payable in Yen. To date, the Company has not invested in instruments designed to hedge currency risks. In addition, the Company's Japanese subsidiary typically carries debt or other obligations due to the Company that may be denominated in either Yen or U.S. dollars. Since the Japanese subsidiary's financial statements are based in Yen and the Company's financial statements are based in U.S. dollars, the Japanese subsidiary and the Company recognize foreign exchange gain or loss in any period in which the value of the Yen rises or falls in relation to the U.S. dollar. A 10% decrease in the value of

the Yen as compared with the U.S. dollar would not be expected to result in a

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significant change in net income or loss.

Item 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

Item 1A. RISK FACTORS

You should carefully consider the risks described below. These risks are not the only risks that we may face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any of the following risks occurs, our business, financial condition or results of operations could be materially and adversely affected which could cause our actual operating results to differ materially from those indicated or suggested by forward-looking statements made in this Quarterly Report on Form 10-Q and in other documents we file with the Securities and Exchange Commission, including without limitation our most recently filed Annual Report on Form 10-K or presented elsewhere by management from time to time.

Current economic conditions could materially adversely affect the Company's operations and performance.

Our operations and performance depend significantly on worldwide economic conditions. The current financial turmoil affecting the banking system and financial markets has resulted in a tightening of the credit markets and a weakening global economy which are contributing to slowdowns in the semiconductor manufacturing industry in which we operate. Specifically, we have experienced a lengthening of the sales cycle and we have also received requests by our customers to defer delivery of equipment. Difficulties in obtaining capital and deteriorating market conditions pose a risk that some of our customers may not be able to obtain necessary financing on reasonable terms which could result in lower sales for the Company. Customers with liquidity issues may lead to additional bad debt expense for the Company. These conditions may also similarly affect key suppliers, which could affect their ability to deliver parts and result in delays on our products.

The current economic conditions and uncertainty about future economic conditions make it challenging for us to forecast our operating results, make business decisions, and identify the risks that may affect our business,

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financial condition and results of operations. If we are not able to timely and appropriately adapt to changes resulting from the difficult macroeconomic

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environment, our business, financial condition or results of operations may be materially and adversely affected.

We depend on a small number of key customers in the semiconductor manufacturing industry for a large portion of our revenues.

The semiconductor manufacturing industry is highly concentrated, with a relatively small number of large semiconductor manufacturers and contract assemblers accounting for a substantial portion of the purchases of semiconductor equipment. Sales to the Company's five largest customers accounted for approximately 99.4% and 96.5% of its net sales in the three and six months ended November 30, 2008, respectively. One customer accounted for approximately 92.8% and 90.5% of the Company's net sales in the three and six months ended November 30, 2008, respectively. Sales to the Company's five largest customers accounted for approximately 99.2% and 98.3% of its net sales in the three and six months ended November 30, 2007, respectively. One customer accounted for approximately 91.3% and 83.6% of the Company's net sales in the three and six months ended November 30, 2007, respectively. No other customers represented more than 10% of the Company's net sales for either fiscal 2009 or fiscal 2008. We expect that sales of our products to a limited number of customers will continue to account for a high percentage of net sales for the foreseeable future. In addition, sales to particular customers may fluctuate significantly from quarter to quarter. The loss of or reduction or delay in an order or orders from a significant customer, or a delay in collecting or failure to collect accounts receivable from a significant customer could adversely affect our business, financial condition and operating results.

Our operating results could be adversely affected by substantial quarterly and annual fluctuations.

We have experienced and expect to continue to experience significant fluctuations in our quarterly and annual operating results. During fiscal years 2008, 2007 and 2006, quarterly net sales have been as low as \$4.6 million and as high as \$10.9 million, and gross margins for quarterly net sales have fluctuated between 40.2% and 58.3%. Our future operating results will depend upon a variety of factors, including sales volume, the timing of significant orders, the mix of products sold, changes in pricing by us, our competitors, customers or suppliers, the length of sales cycles for our products, timing of new product announcements and releases by us and our competitors, market acceptance of new products and enhanced versions of our products, capital spending patterns by customers, manufacturing inefficiencies associated with our new product introductions, our ability to produce systems and products in volume and meet customer requirements, product returns and customer acceptance of product shipments, volatility in our targeted markets, political and economic instability, natural disasters, regulatory changes, possible disruptions caused by expanding existing facilities or moving into new facilities, expenses associated with acquisitions and alliances, and various competitive factors, including price-based competition, competition from vendors employing other technologies, and the amount of products sold under volume purchase arrangements, which tend to have lower selling prices. Accordingly, past performance may not be indicative of future performance.

A substantial portion of our revenues is generated by relatively small volume, high value transactions.

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We derive a substantial portion of our revenues from the sale of a relatively small number of systems which typically range in purchase price from approximately \$300,000 to over \$1 million per system. As a result, the loss or deferral of a limited number of system sales could have a material adverse effect on our net sales and operating results in a particular period. All customer purchase orders are subject to cancellation or rescheduling by the customer with limited penalties, and, therefore, backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. From time to time, cancellations and rescheduling of customer orders have occurred, and delays by our suppliers in providing components or subassemblies

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to us have caused delays in our shipments of our own products. There can be no assurance that we will not be materially adversely affected by future cancellations and rescheduling. A substantial portion of our net sales is typically realized near the end of each quarter. A delay or reduction in shipments near the end of a particular quarter, due, for example, to unanticipated shipment rescheduling, cancellations or deferrals by customers, customer credit issues, unexpected manufacturing difficulties experienced by us, or delays in deliveries by suppliers, could cause net sales in a particular quarter to fall significantly below our expectations.

We rely on continued market acceptance for our FOX system, and may not be successful in attracting new or maintaining our existing customers.

A principal element of our business strategy is to capture an increasing share of the test equipment market through sales of our FOX wafer-level test and burn-in system. The FOX system is newly designed to simultaneously burn-in and functionally test all of the die on a wafer. The WaferPak contactor is an interface device which enables contact between the FOX wafer-level system and all of the die on a wafer, with a single touchdown. The market for the FOX systems is in the very early stages of development. Market acceptance of the FOX system is subject to a number of risks. Before a customer will incorporate the FOX system into a production line, lengthy qualification and correlation tests must be performed. We anticipate that potential customers may be reluctant to change their procedures in order to transfer burn-in and test functions to the FOX system. Initial purchases are expected to be limited to systems or to WaferPak contactors used for these qualifications and for engineering studies. Market acceptance of the FOX system also may be affected by a reluctance of IC manufacturers to rely on relatively small suppliers such as the Company. As is common with new complex products incorporating leading-edge technologies, we may encounter reliability, design and manufacturing issues as we begin volume production and initial installations of FOX systems at customer sites. The failure of the FOX system to achieve market acceptance would have a material adverse effect on our future operating results, long-term prospects and our stock price.

In future periods, we may rely on market acceptance for our ABTS system and we may not be able to achieve sufficient market acceptance to allow our ABTS system to be commercially viable.

In June 2008, we announced shipment of an ABTS beta site system to Integrated Service Technology in Taiwan. Market acceptance of the ABTS system is subject to a number of risks. In order for our ABTS system to become commercially accepted, we must complete engineering development of necessary hardware and software. In addition, the first system, ordered by Integrated Service Technology, must successfully complete customer acceptance. Other customers must then be found who are willing to place orders for ABTS systems in sufficient quantities to allow it to be produced economically.

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We may experience a limited Burn-In System market and we depend upon continued market acceptance for our MAX system.

We have historically derived a substantial portion of our net sales from the sale of dynamic burn-in systems. We believe that the market for burn-in systems is mature and is not expected to have significant long-term growth. In general, process control improvements in the semiconductor industry have tended to reduce burn-in times. In addition, as a given IC product generation matures and yields increase, the required burn-in time may be reduced or eliminated. IC manufacturers, which historically have been our primary customer base, increasingly outsource test and burn-in to independent test labs, which often build their own systems. Our success depends upon the continued acceptance of our MAX burn-in products within these markets. There can be no assurance that the market for burn-in systems will grow, and sales of our MAX burn-in products could decline.

To date, a limited number of customers have ordered MTX systems and it may not achieve broad market acceptance.

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Through the end of fiscal 2008, several companies purchased evaluation units of the MTX system, but only four customers have purchased production quantities. There are no long-term volume purchase commitments with any of these customers. There can be no assurance that these customers will again purchase MTX systems for their production facilities. Since most potential customers have successfully relied on memory testers for many years and their personnel understand the use and maintenance of such systems, we anticipate that they may be reluctant to change their procedures to transfer test functions to the MTX system. Before a customer will transfer test functions to the MTX, the test programs must be translated for use with the MTX system and lengthy correlation tests must be performed. Correlation testing may take up to six months or more. Furthermore, MTX system sales are expected to be primarily limited to new facilities and to existing facilities being upgraded to accommodate new product generations, such as the transition to new memory technologies, including newer generation flash memories, the Double Data Rate DRAMs, and DDR II DRAMs. Construction of new facilities and upgrades of existing facilities have in some cases been delayed or canceled during periodic semiconductor industry downturns. Other companies have purchased MTX systems which are being used only in quality assurance and engineering applications. If we are unable to achieve broad market acceptance for our MTX system, our future prospects and future results of operations will be significantly harmed.

Our sales cycles can be long and unpredictable, which may harm our ability to forecast demand and our future operating performance.

Sales of our systems depend, in significant part, upon the decision of a prospective customer to increase manufacturing capacity or to restructure current manufacturing facilities, either of which typically involves a significant commitment of capital. In addition, the approval process for FOX, ABTS and MTX systems and DiePak carrier sales may require lengthy qualification and correlation testing. In view of the significant investment or strategic issues that may be involved in a decision to purchase FOX, ABTS and MTX systems or DiePak carriers, we may experience delays following initial qualification of our systems as a result of delays in a customer's approval process. For these reasons, our systems typically have a lengthy sales cycle during which we may expend substantial funds and management effort in securing a sale. Lengthy sales cycles subject us to a number of significant risks, including inventory obsolescence and fluctuations in operating results, over which we have little or no control. The loss of individual orders due to the

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lengthy sales and evaluation cycle, or delays in the sale of even a limited number of systems impairs our ability to plan future operating levels and could have a material adverse effect on our business, operating results and financial condition and, in particular, could contribute to significant fluctuations in operating results on a quarterly basis.

Our business may suffer due to risks associated with international sales and operations.

Approximately 61.3% and 42.4% of our net sales for fiscal 2008 and 2007, respectively, were attributable to sales to customers for delivery outside of the United States. We operate sales, service and limited manufacturing organizations in Japan and Germany and a sales and support organization in Taiwan. We expect that sales of products for delivery outside of the United States will continue to represent a substantial portion of our future revenues. Our future performance will depend, in significant part, upon our ability to continue to compete in foreign markets which in turn will depend, in part, upon a continuation of current trade relations between the United States and foreign countries in which semiconductor manufacturers or assemblers have operations. A change toward more protectionist trade legislation in either the United States or such foreign countries, such as a change in the current tariff structures, export compliance or other trade policies, could adversely affect our ability to sell our products in foreign markets. In addition, we are subject to other risks associated with doing business internationally, including longer receivable collection periods and

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greater difficulty in accounts receivable collection, the burden of complying with a variety of foreign laws, difficulty in staffing and managing global operations, risks of civil disturbance or other events which may limit or disrupt markets, international exchange restrictions, changing political conditions and monetary policies of foreign governments.

A substantial portion of our net sales has been in Asia. Turmoil in the Asian financial markets has resulted, and may result in the future, in dramatic currency devaluations, stock market declines, restriction of available credit and general financial weakness. In addition, flash, DRAM, and other memory device prices in Asia have recently declined dramatically, and will likely do so again in the future. These developments may affect us in several ways. We believe that many international semiconductor manufacturers limited their capital spending in fiscal year 2008, and that the uncertainty of the memory market may cause some manufacturers in the future to again delay capital spending plans. The economic conditions in Asia may also affect the ability of our customers to meet their payment obligations, resulting in cancellations or deferrals of existing orders and the limitation of additional orders. In addition, Asian governments have subsidized some portion of fabrication construction. Financial turmoil may reduce these governments' willingness to continue such subsidies. Such developments could have a material adverse affect on our business, financial condition and results of operations.

Approximately 49.3%, 49.1% and 1.6% of our net sales for fiscal 2008 were denominated in U.S. Dollars, Japanese Yen and Euros, respectively. Although a large percentage of net sales to European customers is denominated in U.S. Dollars, substantially all sales to Japanese customers are denominated in Yen. Because a substantial portion of our net sales is from sales of products for delivery outside the United States, an increase in the value of the U.S. Dollar relative to foreign currencies would increase the cost of our products compared to products sold by local companies in such markets. In addition,

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since the price is determined at the time a purchase order is accepted, we are exposed to the risks of fluctuations in the U.S. Dollar exchange rate during the lengthy period from the date a purchase order is received until payment is made. This exchange rate risk is partially offset to the extent our foreign operations incur expenses in the local currency. To date, we have not invested in instruments designed to hedge currency risks. Our operating results could be adversely affected by fluctuations in the value of the U.S. Dollar relative to other currencies.

Our industry is subject to rapid technological changes. Our ability to compete depends in part upon our ability to introduce new products in a timely manner.

The semiconductor equipment industry is subject to rapid technological change and new product introductions and enhancements. Our ability to remain competitive will depend in part upon our ability to develop new products and to introduce these products at competitive prices and on a timely and cost-effective basis. Our success in developing new and enhanced products depends upon a variety of factors, including product selection, timely and efficient completion of product design, timely and efficient implementation of manufacturing and assembly processes, product performance in the field and effective sales and marketing. Because new product development commitments must be made well in advance of sales, new product decisions must anticipate both future demand and the technology that will be available to supply that demand. Furthermore, introductions of new and complex products typically involve a period in which design, engineering and reliability issues are identified and addressed by our suppliers and us. There can be no assurance that we will be successful in selecting, developing, manufacturing and marketing new products that satisfy market demand. Any such failure would materially and adversely affect our business, financial condition and results of operations.

Because of the complexity of our products, significant delays can occur between a product's introduction and the commencement of volume production of

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such product. We have experienced, from time to time, significant delays in the introduction of, and technical and manufacturing difficulties with, certain of its products and may experience delays and technical and manufacturing difficulties in future introductions or volume production of new products. Our inability to complete new product development, or to manufacture and ship products in time to meet customer requirements would materially adversely affect our business, financial condition and results of operations.

We may experience product delays and increased costs associated with new product introductions.

As is common with new complex and software-intensive products, we have encountered reliability, design and manufacturing issues as we began volume production and initial installations of certain products at customer sites. Certain of these issues in the past have been related to components and subsystems supplied to us by third parties who have in some cases limited our ability to address such issues promptly. This process in the past required, and in the future is likely to require, us to incur un-reimbursed engineering expenses, and from time to time to experience larger than anticipated warranty claims and could result in product returns. In the early stages of product development, there can be no assurance that reliability, design and

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manufacturing issues will not be discovered or, that if such issues arise, they can be resolved to the customers' satisfaction or that the resolution of such problems will not cause us to incur significant development costs or warranty expenses or to lose significant sales opportunities.

Future changes in semiconductor technologies may make our products obsolete.

Future improvements in semiconductor design and manufacturing technology may reduce or eliminate the need for our products. For example, improvements in BIST technology, and improvements in conventional test systems, such as reduced cost or increased throughput, may significantly reduce or eliminate the market for one or more of our products. If we are not able to improve our products or develop new products or technologies quickly enough to maintain a competitive position in our markets, we may not be able to grow our business.

Semiconductor business cycles are unreliable and there is always the risk of cancellations and rescheduling.

Our operating results depend primarily upon the capital expenditures of semiconductor manufacturers, semiconductor contract assemblers and burn-in and test service companies worldwide, which in turn depend on the current and anticipated market demand for integrated circuits. The semiconductor and semiconductor equipment industries in general, and the market for flash memories, DRAMs and other memory devices in particular, historically have been highly volatile and have experienced periodic downturns and slowdowns, which have had severe, negative effects on the semiconductor industry's demand for semiconductor capital equipment, including test and burn-in systems manufactured and marketed by the Company. These downturns and slowdowns have adversely affected our operating results in the past. In addition, the purchasing patterns of our customers are also highly cyclical because most customers purchase our products for use in new production facilities or for upgrading existing test lines for the introduction of next generation products. Construction of new facilities and upgrades of existing facilities have in some cases been delayed or canceled during the most recent semiconductor industry downturn. A large portion of our net sales is attributable to a few customers and therefore a reduction in purchases by one or more customers could materially adversely affect our financial results. There can be no assurance that the semiconductor industry will grow in the future at the same rates as it has grown historically. Any downturn or slowdown in the semiconductor industry would have a material adverse effect on our business, financial condition and operating results. In addition, the need to maintain investment in research and development and to maintain customer service and support will limit our ability to reduce our expenses in response to any such downturn or slowdown period.

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The semiconductor equipment manufacturing industry has historically been subject to a relatively high rate of purchase order cancellation by customers as compared to other high technology industry sectors. Manufacturing companies that are the customers of semiconductor equipment companies frequently revise, postpone and cancel capital facility expansion plans. In such cases, semiconductor equipment companies may experience a significant rate of cancellations and rescheduling of purchase orders. There can be no assurance that we will not be materially adversely affected by future cancellations and rescheduling.

Our stock price may vary.

The price for our common stock has fluctuated in the past and may

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fluctuate significantly in the future. We believe that factors such as announcements of developments related to our business, fluctuations in our operating results, failure to meet securities analysts' expectations, general conditions in the semiconductor and semiconductor equipment industries and the worldwide economy, announcement of technological innovations, new systems or product enhancements by us or our competitors, fluctuations in the level of cooperative development funding, acquisitions, changes in governmental regulations, developments in patents or other intellectual property rights and changes in our relationships with customers and suppliers could cause the price of our common stock to fluctuate substantially. In addition, in recent years the stock market in general, and the market for small capitalization and high technology stocks in particular, has experienced extreme price fluctuations which have often been unrelated to the operating performance of affected companies. Such fluctuations could adversely affect the market price of our common stock.

Any future growth may strain our operations and may require us to incur additional expenses to support these expanded operations.

If we are to be successful, we must expand our operations. Such expansion will place a significant strain on our administrative, operational and financial resources. Further, such expansion will result in a continuing increase in the responsibility placed upon management personnel and will require development or enhancement of operational, managerial and financial systems and controls. If we are unable to manage the expansion of our operations effectively, our business, financial condition and operating results will be materially and adversely affected.

We depend on our key personnel. We must attract and retain talented employees.

Our success depends to a significant extent upon the continued service of Rhea Posedel, our Chief Executive Officer, as well as other executive officers and key employees. We do not maintain key person life insurance for our benefit on any of our personnel, and none of our employees is subject to a non-competition agreement with the Company. The loss of the services of any of our executive officers or a group of key employees could have a material adverse effect on our business, financial condition and operating results. Our future success will depend in significant part upon our ability to attract and retain highly skilled technical, management, sales and marketing personnel. There is a limited number of personnel with the requisite skills to serve in these positions, and it has become increasingly difficult for us to hire such personnel. Competition for such personnel in the semiconductor equipment industry is intense, and there can be no assurance that we will be successful in attracting or retaining such personnel. Changes in management could disrupt our operations and adversely affect our operating results.

We may be subject to litigation relating to intellectual property infringement which would be time-consuming, expensive and a distraction from our business.

If we do not adequately protect our intellectual property, competitors may be able to practice our technologies and erode our competitive advantage, and

our business and operating results could be harmed. Litigation may be necessary to enforce or determine the validity and scope of our proprietary rights, and there can be no assurance that our intellectual property rights, if challenged, will be upheld as valid. Such litigation could result in substantial costs and diversion of resources and could have a material adverse

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effect on our operating results, regardless of the outcome of the litigation. In addition, there can be no assurance that any of the patents issued to us will not be challenged, invalidated or circumvented or that the rights granted thereunder will provide competitive advantages to us.

There are no pending claims against us regarding infringement of any patents or other intellectual property rights of others. However, we may receive, in the future, communications from third parties asserting intellectual property claims against us. Such claims could include assertions that our products infringe, or may infringe, the proprietary rights of third parties, requests for indemnification against such infringement or suggestions that we may be interested in acquiring a license from such third parties. There can be no assurance that any such claim made in the future will not result in litigation, which could involve significant expense to us, and, if we are required or deem it appropriate to obtain a license relating to one or more products or technologies, there can be no assurance that we would be able to do so on commercially reasonable terms, or at all.

We are subject to environmental regulations.

Federal, state and local regulations impose various controls on the use, storage, discharge, handling, emission, generation, manufacture and disposal of toxic or other hazardous substances used in our operations. We believe that our activities conform in all material respects to current environmental and land use regulations applicable to our operations and our current facilities, and that it has obtained environmental permits necessary to conduct its business. Nevertheless, the failure to comply with current or future regulations could result in substantial fines being imposed on us, suspension of production, alteration of our manufacturing processes or cessation of operations. Such regulations could require us to acquire expensive remediation equipment or to incur substantial expenses to comply with environmental regulations. Any failure by us to control the use, disposal or storage of, or adequately restrict the discharge of, hazardous or toxic substances could subject us to significant liabilities.

We are subject to internal control evaluation 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. If we fail to maintain effective internal control over financial reporting, or management does not timely assess the adequacy of such internal control, or our independent registered public accounting firm does not timely deliver an unqualified opinion as to the effectiveness of our internal controls, we could be subject to regulatory sanctions and the public's perception may decline. Our independent registered public accounting firm will be required to attest to the effectiveness of our internal control over financial reporting beginning in fiscal 2010.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

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Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held an Annual Meeting of Shareholders on October 28, 2008 (the "Annual Meeting"). There were issued and outstanding on September 12, 2008, the record date, 8,402,720 shares of common stock. There were present at the Annual Meeting in person and by proxy Shareholders of the Company who were holders of 7,721,614 shares of common stock entitled to vote thereat, constituting a quorum. At the Annual Meeting, the following votes were cast for the proposals indicated:

Proposal One: Election of Directors of the Company.

| NOMINEE | VOTES FOR | VOTES WITHHELD |
|--------------------|-----------|----------------|
| ----- | ----- | ----- |
| Rhea J. Posedel | 6,821,722 | 899,892 |
| Robert R. Anderson | 6,822,162 | 899,452 |
| William W.R. Elder | 6,786,361 | 935,253 |
| Mukesh Patel | 7,617,895 | 103,719 |
| Howard T. Slayen | 7,607,017 | 114,597 |

Proposal Two: Approve an amendment of the Company's 2006 Equity Incentive Plan to increase the number of shares reserved for issuance thereunder by an additional 600,000 shares.

| PROPOSAL | TOTAL VOTES FOR | TOTAL VOTES AGAINST | TOTAL VOTES ABSTAIN | TOTAL BROKER NON-VOTES |
|----------|-----------------|---------------------|---------------------|------------------------|
| ----- | ----- | ----- | ----- | ----- |
| TWO | 3,439,155 | 1,209,648 | 10,085 | 3,062,726 |

Proposal Three: Ratify the selection of Burr, Pilger & Mayer LLP as the Company's independent registered public accounting firm for the fiscal year ending May 31, 2009.

| PROPOSAL | TOTAL VOTES FOR | TOTAL VOTES AGAINST | TOTAL VOTES ABSTAIN | TOTAL BROKER NON-VOTES |
|----------|-----------------|---------------------|---------------------|------------------------|
| ----- | ----- | ----- | ----- | ----- |
| Three | 7,653,138 | 56,751 | 11,725 | -- |

Item 5. OTHER INFORMATION

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None.

Item 6. EXHIBITS

The Exhibits listed on the accompanying "Index to Exhibits" are filed as part of, or incorporated by reference into, this report.

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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.

Aehr Test Systems
(Registrant)

Date: January 13, 2009

/s/ RHEA J. POSEDEL

Rhea J. Posedel
Chief Executive Officer and
Chairman of the Board of Directors

Date: January 13, 2009

/s/ GARY L. LARSON

Gary L. Larson
Vice President of Finance and
Chief Financial Officer

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AEHR TEST SYSTEMS
INDEX TO EXHIBITS

| Exhibit No. ----- | Description ----- |
|----------------------|--|
| 31.1 | Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002. |

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Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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