

SemiLEDs Corp
Form 10-Q
July 15, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended May 31, 2014

or

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

For the transition period from to

Commission File Number: **001-34992**

SemiLEDs Corporation

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(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-2735523
(I.R.S. Employer
Identification Number)

**3F, No. 11 Ke Jung Rd., Chu-Nan Site,
Hsinchu Science Park, Chu-Nan 350,
Miao-Li County, Taiwan, R.O.C.**
(Address of principal executive offices)

350
(Zip Code)

+886-37-586788
(Registrant's telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 28,424,493 shares of common stock, par value \$0.0000056 per share, outstanding as of July 7, 2014.

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SEMILEDS CORPORATION

FORM 10-Q for the Quarter Ended May 31, 2014

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****SEMILEDS CORPORATION****Unaudited Condensed Consolidated Balance Sheets**

(In thousands of U.S. dollars and shares, except par value)

	May 31, 2014	August 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 16,084	\$ 36,272
Accounts receivable, net of allowance for doubtful accounts of \$1,471 and \$1,616 as of May 31, 2014 and August 31, 2013, respectively	2,851	2,152
Accounts receivable from related parties, net of allowance for doubtful accounts of \$1,393 and \$1,395 as of May 31, 2014 and August 31, 2013, respectively	47	120
Inventories	9,756	10,500
Prepaid expenses and other current assets	1,597	1,080
Total current assets	30,335	50,124
Property, plant and equipment, net	27,329	30,473
Intangible assets, net	1,556	1,379
Goodwill, net	59	59
Investments in unconsolidated entities	2,239	2,275
Other assets	1,134	1,395
TOTAL ASSETS	\$ 62,652	\$ 85,705
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Current installments of long-term debt	\$ 2,060	\$ 2,294
Accounts payable	2,555	3,534
Accrued expenses and other current liabilities	4,223	6,825
Deferred income, current portion	51	51
Total current liabilities	8,889	12,704
Long-term debt, excluding current installments	4,673	6,169
Deferred income, net of current portion	301	339
Total liabilities	13,863	19,212
Commitments and contingencies (Note 6)		
EQUITY:		
SemiLEDs stockholders' equity		
Common stock, \$0.0000056 par value 75,000 shares and 32,143 shares authorized; 28,424 shares and 27,761 shares issued and outstanding as of May 31, 2014 and August 31, 2013, respectively		
Additional paid-in capital	170,538	169,114
Accumulated other comprehensive income	5,485	5,557
Accumulated deficit	(127,261)	(108,155)
Total SemiLEDs stockholders' equity	48,762	66,516

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Noncontrolling interests		27		(23)
Total equity		48,789		66,493
TOTAL LIABILITIES AND EQUITY	\$	62,652	\$	85,705

See notes to unaudited condensed consolidated financial statements.

Table of Contents**SEMILEDS CORPORATION****Unaudited Condensed Consolidated Statements of Operations****(In thousands of U.S. dollars and shares, except per share data)**

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Revenues, net	\$ 4,615	\$ 3,526	\$ 12,203	\$ 14,583
Cost of revenues	7,408	8,083	20,470	25,781
Gross loss	(2,793)	(4,557)	(8,267)	(11,198)
Operating expenses:				
Research and development	1,025	1,146	3,370	3,403
Selling, general and administrative	2,530	2,171	7,437	8,454
Goodwill impairment (Note 3)		1,077		1,077
Impairment of long-lived assets (Note 3)		851		851
Total operating expenses	3,555	5,245	10,807	13,785
Loss from operations	(6,348)	(9,802)	(19,074)	(24,983)
Other income (expenses):				
Impairment loss on investment (Note 5)		(1,885)		(1,885)
Equity in losses from unconsolidated entities, net	(22)	(74)	(152)	(172)
Interest income (expenses), net	(23)	(25)	(61)	9
Other income, net	53	52	159	158
Foreign currency transaction gains (losses), net	(81)	350	(71)	190
Total other expenses, net	(73)	(1,582)	(125)	(1,700)
Loss before income taxes	(6,421)	(11,384)	(19,199)	(26,683)
Income tax expense				3
Net loss	(6,421)	(11,384)	(19,199)	(26,686)
Less: Net loss attributable to noncontrolling interests	(16)	(431)	(93)	(819)
Net loss attributable to SemiLEDs stockholders	\$ (6,405)	\$ (10,953)	\$ (19,106)	\$ (25,867)
Net loss per share attributable to SemiLEDs stockholders:				
Basic and diluted	\$ (0.23)	\$ (0.40)	\$ (0.68)	\$ (0.94)
Shares used in computing net loss per share attributable to SemiLEDs stockholders:				
Basic and diluted	28,441	27,710	28,039	27,579

See notes to unaudited condensed consolidated financial statements.

Table of Contents**SEMILEDs CORPORATION****Unaudited Condensed Consolidated Statements of Comprehensive Loss****(In thousands of U.S. dollars)**

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Net loss	\$ (6,421)	\$ (11,384)	\$ (19,199)	\$ (26,686)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments, net of tax of \$0 for all periods presented	414	(644)	(71)	396
Comprehensive loss	\$ (6,007)	\$ (12,028)	\$ (19,270)	\$ (26,290)
Comprehensive loss attributable to noncontrolling interests	\$ (17)	\$ (435)	\$ (92)	\$ (809)
Comprehensive loss attributable to SemiLEDs stockholders	\$ (5,990)	\$ (11,593)	\$ (19,178)	\$ (25,481)

See notes to unaudited condensed consolidated financial statements.

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SEMILEDS CORPORATION

Unaudited Condensed Consolidated Statement of Changes in Equity

(In thousands of U.S. dollars and shares)

	Common Stock		Additional	Accumulated	Accumulated	Total	Non-	Total
	Shares	Amount	Paid-in	Other	Deficit	SemiLEDs	Controlling	Equity
			Capital	Comprehensive		Stockholders	Interests	Equity
BALANCE September 1, 2013	27,761	\$	\$ 169,114	\$ 5,557	\$ (108,155)	\$ 66,516	\$ (23)	\$ 66,493
Issuance of common stock under equity incentive plans	663		10			10		10
Stock-based compensation			1,530			1,530		1,530
Purchase of common shares in Ning Xiang			(142)			(142)	142	
Dilution gain on equity method investment			26			26		26
Comprehensive income (loss):								
Net loss					(19,106)	(19,106)	(93)	(19,199)
Other comprehensive income (loss)				(72)		(72)	1	(71)
BALANCE May 31, 2014	28,424	\$	\$ 170,538	\$ 5,485	\$ (127,261)	\$ 48,762	\$ 27	\$ 48,789

See notes to unaudited condensed consolidated financial statements.

Table of Contents**SEMILEDS CORPORATION****Unaudited Condensed Consolidated Statements of Cash Flows****(In thousands of U.S. dollars)**

	Nine Months Ended May 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (19,199)	\$ (26,686)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,953	6,252
Goodwill impairment		1,077
Impairment of long-lived assets		851
Impairment loss on investment		1,885
Stock-based compensation expense	1,530	1,497
Bad debt expense	89	805
Provisions for inventory write-downs	1,618	2,263
Equity in losses from unconsolidated entities, net	152	172
Income recognized on patents assignment	(38)	(38)
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable, net	(687)	1,533
Inventories	(907)	1,292
Prepaid expenses and other	(161)	(189)
Accounts payable	(740)	209
Accrued expenses and other current liabilities	(377)	(724)
Net cash used in operating activities	(13,767)	(9,801)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(1,911)	(2,633)
Purchase of investments	(206)	(2,873)
Payments related to acquisition of business	(2,069)	
Payments for development of intangible assets	(271)	(323)
Proceeds from sale of short-term investments		8,831
Proceeds from sale of investment	114	
Proceeds from return of investment in unconsolidated entity		250
Increase in restricted cash	(122)	
Other investing activities, net	(86)	5
Net cash provided by (used in) investing activities	(4,551)	3,257
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from line of credit	170	
Payments on line of credit	(170)	(1,623)
Proceeds from long-term debt		2,902
Payments of long-term debt	(1,712)	(951)
Proceeds from (payments of) loan from related party	(201)	204
Acquisition of noncontrolling interests		(202)
Other financing activities	12	74
Net cash provided by (used in) financing activities	(1,901)	404
Effect of exchange rate changes on cash and cash equivalents	31	279
NET DECREASE IN CASH AND CASH EQUIVALENTS	(20,188)	(5,861)
CASH AND CASH EQUIVALENTS Beginning of period	36,272	47,228
CASH AND CASH EQUIVALENTS End of period	\$ 16,084	\$ 41,367
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accrual related to property, plant and equipment	\$ 279	\$ 1,749

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See notes to unaudited condensed consolidated financial statements.

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SEMILEDS CORPORATION

Notes to Unaudited Condensed Consolidated Financial Statements

1. Business

SemiLEDs Corporation (SemiLEDs) was incorporated in Delaware on January 4, 2005 and is a holding company for various wholly and majority owned subsidiaries. SemiLEDs and its subsidiaries (collectively, the Company) develop, manufacture and sell high performance light emitting diodes (LEDs). The Company s core products are LED chips and LED components, but lighting products have also become an increasingly important part of the Company s business. A portion of the Company s business consists of the sale of contract manufactured LED products. The Company s customers are concentrated in a few select markets, including Taiwan, the United States and China, as well as in Russia in fiscal 2013.

As of May 31, 2014, SemiLEDs had eight wholly owned subsidiaries and an 87% equity interest in Ning Xiang Technology Co., Ltd. (Ning Xiang). The most significant of these consolidated subsidiaries is SemiLEDs Optoelectronics Co., Ltd. (Taiwan SemiLEDs) located in Hsinchu, Taiwan where a substantial portion of research, development, manufacturing, marketing and sales activities currently take place and where a substantial portion of the assets are held and located. Taiwan SemiLEDs owns a 100% equity interest in Taiwan Bandaoti Zhaoming Co., Ltd., formerly known as Silicon Base Development, Inc., which is engaged in the research, development, manufacture, marketing and sale of LED components. As of May 31, 2014, the Company also owned an 87% interest in Ning Xiang, which consisted of a 51% interest acquired in August 2011, an additional 15% interest acquired in April 2013 and an additional 21% interest acquired in November 2013. Ning Xiang is engaged in the design, manufacture and sale of lighting fixtures and systems. In January 2014, the Company established a wholly owned, currently inactive, subsidiary in New Delhi, India.

SemiLEDs common shares are listed on the NASDAQ Global Select Market under the symbol LEADS since December 8, 2010.

2. Summary of Significant Accounting Policies

Basis of Presentation The Company s unaudited interim condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) and applicable provisions of the rules and regulations of the U.S. Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted as permitted by the rules and regulations of the SEC. Accordingly, these unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K filed with the SEC on November 26, 2013. The unaudited condensed consolidated balance sheet as of August 31, 2013 included herein was derived from the audited consolidated financial statements as of that date.

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The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the Company's consolidated balance sheet as of May 31, 2014, the statements of operations and comprehensive loss for the three and nine months ended May 31, 2014 and 2013, the statement of changes in equity for the nine months ended May 31, 2014, and the statements of cash flows for the nine months ended May 31, 2014 and 2013. The results for the three or nine months ended May 31, 2014 are not necessarily indicative of the results to be expected for the year ending August 31, 2014.

Principles of Consolidation The unaudited interim condensed consolidated financial statements include the accounts of SemiLEDs and its consolidated subsidiaries. All intercompany transactions and balances have been eliminated during consolidation.

Use of Estimates The preparation of unaudited interim condensed consolidated financial statements in conformity with U.S. GAAP 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 unaudited interim condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the collectibility of accounts receivable, inventory net realizable values, realization of deferred tax assets, valuation of stock-based compensation expense, the useful lives of property, plant and equipment and intangible assets, the recoverability of the carrying amount of property, plant and equipment, intangible assets, goodwill and investments in unconsolidated entities, the fair value of acquired tangible and intangible assets, income tax uncertainties, provision for potential litigation costs and other contingencies. Management bases its estimates on historical experience and also on assumptions that it believes are reasonable. Management assesses these estimates on a regular basis; however, actual results could differ materially from those estimates.

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Certain Significant Risks and Uncertainties The Company is subject to certain risks and uncertainties that could have a material and adverse effect on the Company's future financial position or results of operations, which risks and uncertainties include, among others: it has incurred significant losses over the last three fiscal years, any inability of the Company to compete in a rapidly evolving market and to respond quickly and effectively to changing market requirements, any inability of the Company to grow its revenue and/or maintain or increase its margins, it may experience fluctuations in its revenues and operating results, any inability of the Company to protect its intellectual property rights, claims by others that the Company infringes their proprietary technology, and any inability of the Company to raise additional funds in the future.

Concentration of Supply Risk Some of the components and technologies used in the Company's products are purchased and licensed from a limited number of sources and some of the Company's products are produced by a limited number of contract manufacturers. The loss of any of these suppliers and contract manufacturers may cause the Company to incur transition costs to another supplier or contract manufacturer, result in delays in the manufacturing and delivery of the Company's products, or cause it to carry excess or obsolete inventory. The Company relies on a limited number of such suppliers and contract manufacturers for the fulfillment of its customer orders. Any failure of such suppliers and contract manufacturers to perform could have an adverse effect upon the Company's reputation and its ability to distribute its products or satisfy customers' orders, which could adversely affect the Company's business, financial position, results of operations and cash flows.

Concentration of Credit Risk Financial instruments that subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and accounts receivable.

The Company keeps its cash and cash equivalents in demand deposits with prominent banks of high credit quality and invests only in money market funds. Deposits held with banks may exceed the amount of insurance provided on such deposits. As of May 31, 2014 and August 31, 2013, cash and cash equivalents of the Company consisted of the following (in thousands):

Cash and Cash Equivalents by Location	May 31, 2014	August 31, 2013
United States:		
Denominated in U.S. dollars	\$ 7,930	\$ 18,631
Taiwan:		
Denominated in U.S. dollars	6,573	16,158
Denominated in New Taiwan dollars	671	445
Denominated in other currencies	255	264
China (including Hong Kong):		
Denominated in U.S. dollars	262	345
Denominated in Renminbi	392	428
Denominated in H.K. dollars	1	1
Total cash and cash equivalents	\$ 16,084	\$ 36,272

The Company's revenues are substantially derived from the sales of LED products. A significant portion of the Company's revenues are derived from a limited number of customers and sales are concentrated in a few select markets. Management performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable. Management evaluates the need to establish an allowance for doubtful accounts for estimated potential credit losses at each reporting period. The allowance for doubtful accounts is based on the management's assessment of the collectibility of its customer accounts. Management regularly reviews the allowance by considering certain factors, such as historical experience, industry data, credit quality, age of accounts receivable balances and current economic conditions, that may affect a customer's ability to pay.

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Net revenues generated from sales to the top ten customers represented 52% and 47% of the Company's net revenues for the three and nine months ended May 31, 2014, respectively, and 40% and 36% of the Company's net revenues for the three and nine months ended May 31, 2013, respectively.

The Company's revenues have been concentrated in a few select markets, including Taiwan, the United States and China, as well as in Russia in fiscal 2013. Net revenues generated from sales to customers in Taiwan, the United States and China, in the aggregate, accounted for 73% and 58% of the Company's net revenues for the three and nine months ended May 31, 2014, respectively, and 56% and 52% of the Company's net revenues for the three and nine months ended May 31, 2013, respectively. Net revenues generated from sales to customers in Russia accounted for 2% of the Company's net revenues for both the three and nine months ended May 31, 2014, and 9% and 11% of the Company's net revenues for the three and nine months ended May 31, 2013, respectively.

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Noncontrolling Interests Noncontrolling interests are classified in the consolidated statements of operations as part of consolidated net income (loss) and the accumulated amount of noncontrolling interests in the consolidated balance sheets as part of equity. Changes in ownership interest in a consolidated subsidiary that do not result in a loss of control are accounted for as an equity transaction. If a change in ownership of a consolidated subsidiary results in loss of control and deconsolidation, any retained ownership interests are remeasured with the gain or loss reported in net earnings.

Transactions with noncontrolling interests had the following effect on equity attributable to SemiLEDs stockholders (in thousands):

	Three Months Ended May 31, 2014	Nine Months Ended May 31, 2014
Net loss attributable to SemiLEDs stockholders	\$ (6,405)	\$ (19,106)
Transfers to noncontrolling interests:		
Decrease in SemiLEDs additional paid in capital for purchase of common shares in Ning Xiang		(142)
Change from net loss attributable to SemiLEDs stockholders and transfer to noncontrolling interests	\$ (6,405)	\$ (19,248)

Recent Accounting Pronouncement

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on September 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

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Inventories as of May 31, 2014 and August 31, 2013 consisted of the following (in thousands):

	May 31, 2014		August 31, 2013
Raw materials	\$ 2,299	\$	2,193
Work in process	2,776		3,865
Finished goods	4,681		4,442
Total	\$ 9,756	\$	10,500

Inventory write-downs to estimated net realizable values were \$881 thousand and \$1,618 thousand for the three and nine months ended May 31, 2014, respectively, and \$1,055 thousand and \$2,263 thousand for the three and nine months ended May 31, 2013, respectively.

Property, Plant and Equipment

Property, plant and equipment as of May 31, 2014 and August 31, 2013 consisted of the following (in thousands):

	May 31, 2014		August 31, 2013
Buildings and improvements	\$ 14,475	\$	14,510
Machinery and equipment	67,960		67,109
Leasehold improvements	3,520		3,144
Other equipment	2,802		2,686
Construction in progress	1,151		1,028
Total property, plant and equipment	89,908		88,477
Less: Accumulated depreciation, amortization and impairment	(62,579)		(58,004)
Property, plant and equipment, net	\$ 27,329	\$	30,473

In connection with the termination of the lease for the Company's manufacturing operations at Sinwu, Taiwan (the Sinwu Facility), the useful lives of certain leasehold improvements were shortened because the Company would cease using the Sinwu Facility on July 15, 2014, resulting in an accelerated charge of depreciation for the leasehold improvements for the three months ended May 31, 2014 of \$275 thousand.

Intangible Assets

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Intangible assets as of May 31, 2014 and August 31, 2013 consisted of the following (in thousands):

May 31, 2014				
	Weighted Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patents and trademarks	14	\$ 1,329	\$ 231	\$ 1,098
Acquired technology	5	717	259	458
Total		\$ 2,046	\$ 490	\$ 1,556

August 31, 2013				
	Weighted Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization and Impairment(1)	Net Carrying Amount
Patents and trademarks	15	\$ 973	\$ 161	\$ 812
Acquired technology	5	719	152	567
Customer relationships	5	1,337	1,337	
Total		\$ 3,029	\$ 1,650	\$ 1,379

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(1) Includes an impairment charge of \$851 thousand recognized in the year ended August 31, 2013 to write down the intangible asset for customer relationships to its fair value of zero before the end of its estimated useful life.

In the third quarter of fiscal 2013, in conjunction with the interim goodwill impairment test discussed further below, management evaluated the recoverability of the long-lived assets of the Company's Ning Xiang asset group, which consists primarily of customer relationships intangible asset. The Company concluded this intangible asset no longer had any value and consequently recognized an impairment charge of \$851 thousand, which represented the net carrying amount of this intangible asset at that time, during the three months ended May 31, 2013.

Goodwill

In the third quarter of fiscal 2013, due to a lower than expected revenue, profitability and cash flows reported by the Company's Ning Xiang reporting unit, management determined that there were indicators of potential goodwill impairment. After writing down the customer relationships intangible asset described above, management determined the fair values of the underlying assets and liabilities within this reporting unit. Consequently, the implied fair value of goodwill was zero and, as a result, a goodwill impairment charge of \$1,077 thousand was recognized during the three months ended May 31, 2013. The fair value of the Ning Xiang reporting unit was determined based on the present value of expected future net cash flows discounted at the weighted average cost of capital of Ning Xiang of 10%. The primary circumstance leading to the impairment of customer relationships, as discussed above, and goodwill was due to management's updated long-term financial forecasts, which reflected lower estimated near-term and longer-term revenues and profitability compared to estimates developed at the time of the acquisition in August 2011.

In July 2013, the Company recognized goodwill on the acquisition of an LED production business discussed in Note 4 below in the amount of \$59 thousand. All of the goodwill was assigned to the Company's reporting unit associated with the manufacture and sale of LED chips and LED components. No impairment charge was recorded in the three and nine months ended May 31, 2014.

4. Acquisition of Business

In July 2013, the Company, through a wholly owned subsidiary, entered into an agreement with several third parties to acquire an LED production business, which included certain contractual rights, intellectual property, equipment and assets related to the production of LED components, and assumed certain trade and business-related payables. Pursuant to such agreement, the Company entered into an assignment and assumption agreement dated July 31, 2013 to acquire certain equipment and patents used in the manufacturing of LED components, originally executed by one of the foregoing third parties. Total cash consideration for the acquisition amounted to \$2,921 thousand. The Company paid \$888 thousand in fiscal 2013 and the remaining balance in the amount of \$2,069 thousand during the nine months ended May 31, 2014. Payments were translated into U.S. dollar at the exchange rates in effect at the time of payment.

5. Investments in Unconsolidated Entities

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The Company's ownership interest and carrying amounts of investments in unconsolidated entities as of May 31, 2014 and August 31, 2013 consisted of the following (in thousands, except percentages):

	May 31, 2014		August 31, 2013	
	Percentage Ownership	Amount	Percentage Ownership	Amount
Equity method investments:				
SILQ (Malaysia) Sdn. Bhd. (SILQ)	33%	\$ 256	50%	\$ 289
Xurui Guangdian Co., Ltd. (China SemiLEDs)	49%		49%	
Cost method investments	Various	1,983	Various	1,986
Total investments in unconsolidated entities		\$ 2,239		\$ 2,275

There were no dividends received from unconsolidated entities through May 31, 2014.

Equity Method Investments

As of August 31, 2013, the Company and the other investor in SILQ, a joint venture in Malaysia which is engaged in the design, manufacture and sale of lighting fixtures and systems, each owned a 50% equity interest in SILQ. In January 2014, the Company participated in SILQ's capital increase and contributed \$76 thousand. Following the capital increase, the Company's equity

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interest in SILQ was diluted from 50% to 49%, and consequently, the Company recognized a gain on dilution of its investment of \$26 thousand. The dilution gain was recognized as additional paid in capital in the consolidated statement of changes in equity. In April 2014, the Company sold part of its equity interest in SILQ to the other investor for a cash consideration of \$114 thousand and recognized a gain on sale of investment of \$37 thousand. The gain was reported in the consolidated statements of operations in equity in losses from unconsolidated entities. Upon consummation of the sale, the Company's equity interest in SILQ was reduced from 49% to 33%. The Company subsequently invested \$130 thousand in SILQ's capital increase and its equity interest remains unchanged.

The carrying amount of the Company's investment in China SemiLEDs was reduced to zero as of August 31, 2012 as a result of the Company recognizing its proportionate share of the net loss reported by China SemiLEDs. The Company has suspended using the equity method of accounting and will no longer amortize the excess of the Company's share of the net assets of China SemiLEDs over the carrying amount of this investment until its share of future income, if any, from China SemiLEDs is sufficient to recover its share of the cumulative losses that have not previously been recognized.

The fair value of the Company's investments in the non-marketable stock of its equity method investees is not readily available. These investments, except for China SemiLEDs which had a zero carrying amount at May 31, 2014, are assessed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

Cost Method Investments

In October 2012, the Company acquired a 9.9% equity interest in High Power Optoelectronics, Inc. (HPO) for total cash consideration of \$2.9 million and had an option to increase its equity interest to more than 50% within one year of the acquisition. The fair values of the Company's cost method investments are not readily available. All cost method investments are assessed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable. In the third quarter of fiscal 2013, management reviewed the operating performance and financial condition of HPO based on the latest available financial statements of the investee and other publicly available information. Management considered the extent and duration of time to which the fair value of the investment has been less than its carrying amount, the financial condition of the investee and the prospect for recovery in the near term, and recognized an other-than-temporary impairment loss of \$1,885 thousand on its investment in HPO for the year ended August 31, 2013.

6. Commitments and Contingencies

Operating Lease Agreements The Company has several operating leases with unrelated parties, primarily for land, plant and office spaces in Taiwan, which expire at various dates between January 2015 and December 2020. Lease expense related to these operating leases was \$343 thousand and \$925 thousand for the three and nine months ended May 31, 2014, respectively, and \$216 thousand and \$620 thousand for the three and nine months ended May 31, 2013, respectively. Lease expense is recognized on a straight-line basis over the term of the lease.

In January 2014, the Company announced the relocation and consolidation of its manufacturing operations at the Sinwu Facility to other of its existing facilities. The lease term for the Sinwu Facility is 10 years, expiring on November 30, 2016. In accordance with the lease agreement, the Company provided a six-month written notice to terminate the lease effective from July 15, 2014.

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The aggregate future noncancellable minimum rental payments for the Company's operating leases as of May 31, 2014 consisted of the following (in thousands):

Years Ending August 31,		Operating Leases
Remainder of 2014	\$	189
2015		518
2016		437
2017		441
2018		272
Thereafter		218
Total	\$	2,075

Purchase Obligations The Company had purchase commitments for property, plant and equipment in the amount of \$4.2 million and \$3.2 million as of May 31, 2014 and August 31, 2013, respectively.

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Litigation The Company is directly or indirectly involved from time to time in various claims or legal proceedings arising in the ordinary course of business. On July 10, 2013, a putative class action lawsuit was filed in the United States District Court for the Southern District of New York against the Company and certain of its current and former officers and directors, styled as *Huard v. SemiLEDs Corporation, et al.*, alleging violations of the U.S. federal securities laws. On July 31, 2013, a second investor filed a complaint, styled as *Mohammad v. SemiLEDs Corporation, et al.* On September 30, 2013, the Court appointed Mohammad Yasir as lead plaintiff and Pomerantz Grossman Hufford Dahlstrom & Gross LLP as lead counsel. On November 15, 2013, the lead plaintiff filed its Amended Complaint, styled as *In re SemiLEDs Corporation Litigation*, Civil Action No. 1:13-cv-04776-DLC (S.D.N.Y.). The Amended Complaint alleged one count of violation of Section 10(b) of the Exchange Act and one count of violation of Section 20(a) of the Exchange Act, both arising out of alleged misstatements made by the Company and certain of its current and former officers and directors in connection with the Company's initial public offering and the Company's results in the first, second, and third quarter of 2011. On February 20, 2014, the plaintiffs filed a notice of voluntary dismissal of the action. On February 21, 2014, the Court signed the notice of dismissal and the case was closed. There were no material pending legal proceedings and claims as of May 31, 2014.

7. Common Stock

In April 2014, SemiLEDs' stockholders approved an amendment to the Restated Certificate of Incorporation to increase the number of authorized shares of common stock to 75,000 thousand shares with a par value of \$0.0000056 per share.

8. Stock-based Compensation

The Company currently has one equity incentive plan (the 2010 Plan), which provides for awards in the form of restricted shares, stock units, stock options or stock appreciation rights to the Company's employees, officers, directors and consultants. In April 2014, SemiLEDs' stockholders approved an amendment to the 2010 Plan that increases the number of shares authorized for issuance under the plan by an additional 2,500 thousand shares. Prior to SemiLEDs' initial public offering, the Company had another stock-based compensation plan (the 2005 Plan), but awards are made from the 2010 Plan after the initial public offering. Options outstanding under the 2005 Plan continue to be governed by its existing terms.

A total of 6,349 thousand and 3,849 thousand shares of common stock was reserved for issuance under the 2005 Plan and 2010 Plan as of May 31, 2014 and August 31, 2013, respectively. As of May 31, 2014 and August 31, 2013, there were 4,496 thousand and 2,654 thousand shares of common stock available for future issuance under the equity incentive plans.

During fiscal 2013, SemiLEDs granted options for 100 thousand shares of SemiLEDs' common stock and 1,195 thousand restricted stock units to the Company's executives and employees. These options and stock units vest over four years at a rate of 25% on each anniversary of the vesting start date and the options have a contractual term of ten years, subject to earlier expiration in the event of the holder's termination. The exercise price of stock options and the grant-date fair value of stock units were equal to the closing price of the common stock on the date of grant. In addition, in February 2013, SemiLEDs granted 211 thousand restricted stock units to its directors that vested 100% on February 6, 2014. The grant-date fair value of the restricted stock units was \$0.71 per unit. Each restricted stock unit represents the contingent right to one share of SemiLEDs' common stock.

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In April 2014, SemiLEDs granted 75 thousand restricted stock units to its directors that vest 100% on the earlier of the first anniversary of the vesting start date of April 21, 2014 and the date of the next annual meeting. The grant-date fair value of the restricted stock units was \$1.05 per unit.

In May 2014, SemiLEDs granted 410 thousand restricted stock units that vest over four years at a rate of 25% on each anniversary of the vesting start date of May 9, 2014, and 122 thousand restricted stock units that vest 100% on May 9, 2015, subject to earlier expiration in the event of the holder's termination. SemiLEDs also granted 366 thousand performance-based restricted stock units that vest upon the attainment of certain performance targets in the fiscal years ending August 31, 2015, 2016 or 2017. The grant-date fair value of these restricted stock units was \$1.01 per unit.

The grant-date fair value of stock options is determined using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model requires inputs including the market price of SemiLEDs' common stock on the date of grant, the term that the stock options are expected to be outstanding, the implied stock volatilities of several of the Company's publicly-traded peers over the expected term of stock options, risk-free interest rate and expected dividend. Each of these inputs is subjective and generally requires significant judgment to determine. The grant-date fair value of stock units is based upon the market price of SemiLEDs' common stock on the date of the grant. This fair value is amortized to compensation expense over the vesting term.

Stock-based compensation expense is recorded net of estimated forfeitures such that expense is recorded only for those stock-based awards that are expected to vest. A forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent

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periods if actual forfeitures differ from initial estimates. A forfeiture rate of zero is estimated for stock-based awards with vesting term that is less than or equal to one year from the date of grant.

A summary of the stock-based compensation expense for the three and nine months ended May 31, 2014 and 2013 was as follows (in thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Cost of revenues	\$ 191	\$ 211	\$ 581	\$ 653
Research and development	51	87	273	318
Selling, general and administrative	240	222	676	526
	\$ 482	\$ 520	\$ 1,530	\$ 1,497

9. Net Loss Per Share of Common Stock

The following stock-based compensation plan awards were excluded from the computation of diluted net loss per share of common stock for the periods presented because including them would have been anti-dilutive (in thousands of shares):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Stock units and stock options to purchase common stock	277	787	567	580

10. Income Taxes

The Company's loss before income taxes for the three and nine months ended May 31, 2014 and 2013 consisted of the following (in thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
U.S. operations	\$ (476)	\$ (473)	\$ (1,464)	\$ (1,767)
Foreign operations	(5,945)	(10,911)	(17,735)	(24,916)
Loss before income taxes	\$ (6,421)	\$ (11,384)	\$ (19,199)	\$ (26,683)

Unrecognized Tax Benefits

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As of both May 31, 2014 and August 31, 2013, the Company had unrecognized tax benefits related to tax positions taken in prior periods of \$145 thousand. The entire amount of the unrecognized tax benefits would impact the Company's effective tax rate if recognized. The impact would be offset by an adjustment to the valuation allowance.

Accrued interest and penalties related to unrecognized tax benefits were immaterial. The Company files income tax returns in the United States, various U.S. states and certain foreign jurisdictions. The tax years 2005 through 2013 remain open in most jurisdictions. The Company is not currently under examination by income tax authorities in federal, state or foreign jurisdictions.

11. Related-Party Transactions

In April 2013, a majority owned subsidiary entered into a one-year unsecured NT dollar denominated loan in the amount of \$0.2 million with one of its shareholders to fulfill short-term financing needs. The loan bears a fixed interest rate of 3% per annum. Management believes that the terms of this transaction are at current market rates and would not have been any different had it been negotiated with an independent third party. The subsidiary made a partial payment on the principal loan amount in January 2014 and the final payment in April 2014. As of August 31, 2013, amounts due to related parties of \$0.2 million were recorded in other current liabilities.

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

Forward Looking Statements

This Quarterly Report on Form 10-Q, or this Quarterly Report, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical facts contained in this Quarterly Report, including statements regarding the future results of operations of SemiLEDs Corporation, or we, our or the Company, and financial position, strategy and plans, and our expectations for future operations, are forward-looking statements. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. The words believe, may, should, plan, potential, project, will, estimate, continue, anticipate, design, intend, expect and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, and actual results and the timing of certain events could differ materially and adversely from those anticipated or implied in the forward-looking statements as a result of many factors. These factors include, among other things,

- Our ability to reduce our net losses and to restore our operations to profitability.

- Our ability to successfully introduce new products that we can produce and that customers will purchase in such amounts as to be sufficiently profitable to cover the costs of developing and producing these products, as well as providing us additional net income from operations.

- Our ability to effectively develop, maintain and expand our sales and distribution channels.

- Our ability to successfully manage our operations in the face of the cyclical nature, rapid technological change, rapid product obsolescence, declining average selling prices and wide fluctuations in supply and demand typically found in the LED market.

- Competitive pressures from existing and new companies.

- Our ability to grow our revenues generated from the sales of our products and to control our expenses.

- Our ability to implement our cost reduction programs effectively.

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- Loss of any of our key personnel, or our failure to attract, assimilate and retain other highly qualified personnel.
- Intellectual property infringement or misappropriation claims by third parties against us or our customers, including our distributor customers.
- Our ability to improve our liquidity and access alternative sources of funding.
- The failure of LEDs to achieve widespread adoption in the general lighting market, or if alternative technologies gain market acceptance.
- Our ability to improve our gross margins.
- The loss of key suppliers or contract manufacturers.
- The inability of contract manufacturers to produce products that satisfy our requirements.
- Our ability to effectively expand or upgrade our production facilities or do so in a timely or cost-effective manner.
- Difficulty in managing our future growth or in responding to a need to contract operations, and the associated changes to our operations.
- Adverse development in those selected markets, including Taiwan, the United States and China, where our revenues are concentrated.

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- Our ability to develop and execute upon a new strategy to exploit the China market.
- The reduction or elimination of government investment in LED lighting or the elimination of, or changes in, policies in certain countries that encourage the use of LEDs over some traditional lighting technologies.
- Our ability to cost-effectively produce LED chips using larger wafer sizes.
- Our ability to implement our product innovation strategy effectively, particularly in view of the prohibition against our (and/or our assisting others in) making, using, importing, selling and/or offering to sell in the United States our accused products and/or any device that includes an accused product after October 1, 2012 as a result of the injunction agreed to in connection with the Cree Inc., or Cree, litigation.
- Loss of customers.
- Failure of our strategy of marketing and selling our products in jurisdictions with limited intellectual property enforcement regimes.
- Lack of marketing and distribution success by our third-party distributors.
- Our customers' ability to produce and sell products incorporating our LED products.
- Our failure to adequately prevent disclosure of trade secrets and other proprietary information.
- Ineffectiveness of our disclosure controls and procedures and our internal control over financial reporting.
- Our ability to profit from existing and future joint ventures, investments, acquisitions and other strategic alliances.

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- Impairment of goodwill, long-lived assets or investments;
- Undetected defects in our products that harm our sales and reputation and adversely affect our manufacturing yields.
- The availability of adequate and timely supply of electricity and water for our manufacturing facilities.
- Our ability to comply with existing and future environmental laws and the cost of such compliance.
- The non-compete provisions between us and Xurui Guangdian Co., Ltd., or China SemiLEDs, constraining our ability to grow in China, or actions by China SemiLEDs or the other shareholders of China SemiLEDs that are detrimental to us.
- The ability of SemiLEDs Optoelectronics Co., Ltd., or Taiwan SemiLEDs, to make dividends and other payments to us.
- Our ability to obtain necessary regulatory approvals to make further investments in Taiwan SemiLEDs.
- Catastrophic events such as fires, earthquakes, floods, tornados, tsunamis, typhoons, pandemics, wars, terrorist activities and other similar events, particularly if these events occur at or near our operations, or the operations of our suppliers, contract manufacturers and customers.
- The effect of the legal system in the People's Republic of China, or the PRC.
- Labor shortages, strikes and other disturbances that affect our operations.
- Deterioration in the relations between the PRC and Taiwan governments.
- Fluctuations in the exchange rate among the U.S. dollar, the New Taiwan, or NT, dollar, the Japanese Yen and other currencies in which our sales, raw materials and component purchases and capital expenditures are denominated.

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- Our ability to obtain additional equity capital or credit when necessary for our operations, the difficulty of which may increase if our common stock is delisted from The NASDAQ Stock Market.
- The effect of new disclosure requirements under the new provisions of the Dodd-Frank Act relating to conflict minerals, which could increase our costs and limit the supply of certain metals used in our products and affect our reputation with customers and shareholders.
- The impact on the trading price of our common stock if we are delisted for failure to meet the NASDAQ continued listing requirements if our stock trades below \$1 per share.
- The costs and other effects of litigation.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We have not assumed any obligation to, and you should not expect us to, update or revise these statements because of new information, future events or otherwise.

For more information on the significant risks that could affect the outcome of these forward-looking statements, see Item 1A Risk Factors in Part I of our Annual Report on Form 10-K for the fiscal year ended August 31, 2013, or the 2013 Annual Report, and those contained in Part II, Item 1A of this Quarterly Report, and other information provided from time to time in our filings with the Securities and Exchange Commission, or the SEC.

The following discussion and analysis of our financial condition and results of operations is based upon and should be read in conjunction with the unaudited interim condensed consolidated financial statements and the notes and other information included elsewhere in this Quarterly Report, in our 2013 Annual Report, and in other filings with the SEC.

Company Overview

We develop, manufacture and sell LED chips and LED components. Our products are used primarily for general lighting applications, including street lights and commercial, industrial and residential lighting. Our LED chips may also be used in specialty industrial applications, such as ultraviolet, or UV, curing of polymers, LED light therapy in medical/cosmetic applications, counterfeit detection, LED lighting for horticulture applications, architectural lighting and entertainment lighting. Our core products are LED chips and LED components, but lighting products have also become an increasingly important part of our business.

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Utilizing our patented and proprietary technology, our manufacturing process begins by growing upon the surface of a sapphire wafer, or substrate, several very thin separate semiconductive crystalline layers of gallium nitride, or GaN, a process known as epitaxial growth, on top of which a mirror-like reflective silver layer is then deposited. After the subsequent addition of a copper alloy layer and finally the removal of the sapphire substrate, we further process this multiple-layered material to create individual LED chips.

We sell blue, white, green and UV LED chips under our MvpLED brand to a customer base that is heavily concentrated in a few select markets, including Taiwan, the United States and China, as well as in Russia in fiscal 2013. We also sell our new Enhanced Vertical, or EV, LED product series in blue, white, green and UV. We sell our LED chips to packagers or to distributors, who in turn sell to packagers. In addition, we package a portion of our LED chips into LED components, which we sell to distributors and end-customers in selected markets. Our lighting products customers consist primarily of original design manufacturers of lighting products and the end-users of lighting devices. We also contract other manufacturers to produce for our sale certain LED products, and for certain aspects of our product fabrication, assembly and packaging process, based on our design and technology requirements and under our quality control specifications and final inspection process.

We have developed advanced capabilities and proprietary know-how in:

- reusing sapphire substrate in subsequent production runs;
- optimizing our epitaxial growth processes to create layers that efficiently convert electrical current into light;
- employing a copper alloy base manufacturing technology to improve our chip's thermal and electrical performance;
- utilizing nanoscale surface engineering to improve usable light extraction; and

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- developing a LED structure that generally consists of multiple epitaxial layers which are vertically-stacked on top of and a copper alloy base.

These technical capabilities enable us to produce LED chips that can provide efficacies of greater than 120 lumens per watt when packaged. We believe these capabilities and know-how also allow us to reduce our manufacturing costs and our dependence on sapphire, a costly raw material used in the production of sapphire-based LED devices. In addition, we believe our technological know-how and capabilities will help facilitate our migration to larger wafer sizes.

We were incorporated in the State of Delaware on January 4, 2005 and sold our first LED chips in November 2005. We are a holding company for various wholly and majority owned subsidiaries. Our most significant subsidiary is our wholly owned operating subsidiary, Taiwan SemiLEDs, where a substantial portion of our assets are held and located, where a substantial portion of our research, development, manufacturing, marketing and sales activities take place, and where most of our employees are based. Taiwan SemiLEDs owns a 100% equity interest in Taiwan Bandaoti Zhaoming Co., Ltd., formerly known as Silicon Base Development, Inc., which is engaged in the research, development, manufacture, marketing and sale of LED components. As of May 31, 2014, we also owned an 87% interest in Ning Xiang Technology Co., Ltd., or Ning Xiang, which consisted of a 51% interest that we acquired in August 2011, an additional 15% interest that we acquired in April 2013, and an additional 21% interest that we acquired in November 2013. Ning Xiang is engaged in the design, manufacture and sale of lighting fixtures and systems.

We also have interests in unconsolidated joint ventures that we have accounted for as equity method investments and as such have not consolidated for financial reporting purposes. As of May 31, 2014, we owned a 33% interest in SILQ (Malaysia) Sdn. Bhd., or SILQ, a joint venture established in Malaysia to design, manufacture and sell lighting fixtures and systems. Originally, we and the other investor each owned a 50% equity interest in the joint venture. In January 2014, we participated in SILQ's capital increase and contributed \$76 thousand. Following this capital increase, our equity interest in SILQ was diluted from 50% to 49%. In April 2014, we sold part of our equity interest in SILQ to the other investor in SILQ for a cash consideration of \$114 thousand. Upon consummation of the sale, our equity interest in SILQ was reduced from 49% to 33%. We subsequently invested \$130 thousand in SILQ's capital increase and our equity interest remains unchanged.

Key Factors Affecting Our Financial Condition, Results of Operations and Business

The following are key factors that we believe affect our financial condition, results of operations and business:

- **Industry growth and demand for products and applications using LEDs.** The overall adoption of LED lighting devices to replace traditional lighting sources is expected to influence the growth and demand for LED chips and impact our financial performance. We believe the potential market for LED lighting will continue to expand. LEDs for efficient generation of UV light are also starting to gain attention for various medical, germicidal and industrial applications. Since a substantial portion of our LED chips, LED components and our lighting products are used by end-users in general lighting applications and specialty industrial applications such as UV curing, medical/cosmetic, counterfeit detection, horticulture, architectural lighting and entertainment lighting, the adoption of LEDs into these applications will have a strong impact on the demand of LED chips generally and, as a result, for our LED chips, LED components and LED lighting products. Fluctuations in demand for LED lights products will also affect the results of Ning Xiang.

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- ***Average selling price of our products.*** The average selling price of our products may decline for a variety of factors, including prices charged by our competitors, the efficacy of our products, our cost basis, changes in our product mix, the size of the order and our relationship with the relevant customer, as well as general market and economic conditions. Competition in the markets for LED products is intense, and we expect that competition will continue to increase, thereby creating a highly aggressive pricing environment. For example, some of our competitors have in the past reduced their average selling prices, and the resulting competitive pricing pressures have caused us to similarly reduce our prices, accelerating the decline in our revenues and the gross margin of our products. When prices decline, we must also write down the value of our inventory. Furthermore, the average selling prices for our LED products have typically decreased over product life cycles. Therefore, our ability to continue to innovate and offer competitive products that meet our customers' specifications and pricing requirements, such as higher efficacy LED products at lower costs, will have a material influence on our ability to improve our revenues and product margins, although in the near term the introduction of such higher efficacy LED chips may further reduce the selling prices of our existing products or render them obsolete. Reduction in the average selling price of LED lights products will also affect the results of Ning Xiang.

- ***Changes in our product mix.*** We anticipate that our gross margins will fluctuate from period to period as a result of the mix of products that we sell and the utilization of our manufacturing capacity in any given period, among other

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things. For example, in fiscal 2012, we placed greater emphasis on the sales of LED components rather than the sales of LED chips for which we have been forced to cut prices on older inventory. In particular, we sold a significant volume of a category of lower-priced LED components designed to meet our customers' demand. While such a shift in product mix to lower-priced products lowered our average selling price, the significant sales volume helped to improve revenues and gross margin in fiscal 2012. We intend to continue to pursue opportunities for profitable growth in areas of business where we see the best opportunity for our new EV LED product series of LED chips (particularly the UV market) and continue to expand sales of lower-priced LED components as appropriate. However, as we expand and diversify our product offerings and with varying average selling prices, a change in the mix of products that we sell in any given period may increase volatility in our revenues and gross margin from period to period.

- ***Our ability to reduce costs to offset lower average prices.*** Competitors may reduce average selling prices faster than our ability to reduce costs, and competitive pricing pressures may accelerate the rate of decline of our average selling prices. To address increased pricing pressure, we have invested in the development of larger wafer sizes, in particular using 4" wafers, which we believe should lower our production costs. We have substantially converted our manufacturing of LED chips based on 4" wafer technology. We have also improved and increased our production yields to reduce the per-unit cost of production for our products. However, such cost savings currently have had limited impact on our gross profit, as we suffered from the underutilization of our manufacturing capacity, primarily for our LED chips, starting in the fourth quarter of our fiscal 2011 and continuing through the third quarter of our fiscal 2014, and must absorb a high level of fixed cost, such as depreciation. While we continue to focus on managing our costs and expenses, over the long term we expect to be required to invest substantially in LED development and production equipment if we are to grow.

- ***Our ability to continue to innovate.*** As part of our growth strategy, we plan to continue to be innovative in product design, to deliver new products and to improve our manufacturing efficiencies. Our continued success depends on our ability to develop and introduce new, technologically advanced and lower cost products, such as more efficient, higher brightness LED chips. If we are unable to introduce new products that are commercially viable and meet rapidly evolving customer requirements or keep pace with evolving technological standards and market developments or are otherwise unable to execute our product innovation strategy effectively, we may not be able to take advantage of market opportunities as they arise, execute our business plan or be able to compete effectively. During the fourth quarter of our fiscal 2012, we introduced our new EV LED product series, capable of operating at a higher junction temperature and with higher thermal endurance, as well as our new ceramic LED component products, the C35 emitters, that incorporates the EV chip and also offers customers greater flexibility in making color choices. In June 2013, we expanded our UV LED product portfolio with the launch of mid- and high-power product series designed for industrial applications such as printing, coating, curing, signage and medical/cosmetic uses. We also broadened our LED components portfolio through an acquisition in July 2013. In November 2013, we announced the launch of our new compact multi-color LED component that integrates our vertical LED structure, white color chip and ceramic packaging technologies, which offers our customers easy color mixing and higher integration that simplifies the design of lighting fixtures and reduces the number of LED components used. In March 2014, we announced our new EV-W series of white LED chips, which allow our customers to eliminate phosphor application from the packaging process, and improves color precision and uniformity. Our near-term success will depend upon how attractive these products are to our customers versus competitors' offerings and our customers' willingness and promptness in qualifying our new products.

- ***General economic conditions and geographic concentration.*** Many countries including the United States and the European Union members have instituted, or have announced plans to institute, government regulations and programs designed to encourage or mandate increased energy efficiency in lighting. These actions include in certain cases banning the sale after specified dates of certain forms of incandescent lighting, which are advancing the adoption of more energy efficient lighting solutions such as LEDs. The global financial crisis that began in late 2007 caused extreme disruption in the financial markets. Although the disruption in the financial markets moderated thereafter, the global financial markets continue to reflect uncertainty about a sustained economic recovery. When the global economy slows or a financial crisis occurs, consumer and government confidence declines, with levels of government grants and subsidies for LED adoption and consumer spending likely to be adversely impacted. Our revenues have been concentrated in a few select markets, including Taiwan, the United States and China, as well as in Russia in fiscal 2013. Given that we are operating in a rapidly changing industry, our sales in specific markets may fluctuate from quarter to quarter. Therefore, our financial results will be impacted by general economic and political conditions in such markets. For example, some of our customers in Russia have experienced temporary liquidity constraints as a result of the impact of the banking crisis in

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Cyprus in March 2013 on the Russian economy, which have led to reduced and/or delayed purchases of our products by these customers. The recent sanctions imposed by the United States and European Union against Russia over the Ukrainian crisis could also have a negative impact on our sales and results of

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operations. In addition, we have historically derived a significant portion of our revenues from a limited number of customers. Some of our largest customers and what we produce/have produced for them have changed from quarter to quarter primarily as a result of the timing of discrete, large project-based purchases and broadening customer base, among other things. For the three and nine months ended May 31, 2014, sales to our three largest customers, in the aggregate, accounted for 30% and 29% of our revenues, respectively.

- ***Intellectual property issues.*** Competitors of ours and other third parties have in the past and will likely from time to time in the future allege that our products infringe on their intellectual property rights. Defending against any intellectual property infringement claims would likely result in costly litigation and ultimately may lead to our not being able to manufacture, use or sell products found to be infringing. In June 2012, we settled an intellectual property dispute involving Cree. We agreed to dismiss amended complaints filed against each other without prejudice. We agreed to the entry of a permanent injunction that was effective October 1, 2012 that precludes us from (and/or from assisting others in) making, using, importing, selling and/or offering to sell in the United States certain accused products and/or any device that includes such an accused product after that date and to payment of a settlement fee for past damages. All accused products sold before the date of settlement are released under this agreement and our customers and distributors are specifically released. All remaining claims between Cree and us were withdrawn without prejudice, with each retaining the right to assert them in the future. However, other third parties may also assert infringement claims against our customers with respect to our products, or our customers' products that incorporate our technologies or products. Any such legal action or the threat of legal action against us, or our customers, could impair such customers' continued demand for our products. This could prevent us from growing or even maintaining our revenues, or cause us to incur additional costs and expenses, and adversely affect our financial condition and results of operations.

- ***Our ability to realize our strategic initiatives.*** We have grown our business in part through strategic alliances and acquisitions. For example, our China strategy was initially premised on continuing our growth in China through China SemiLEDs; however, the launch of China SemiLEDs was not successful. We now no longer view China SemiLEDs as the vehicle to drive our growth in China. As the world's second largest economy and one that is geographically close to our manufacturing operations, China continues to represent a key market for our products and we have been working towards formulating certain strategic alternatives to exploit the opportunities that it presents, including, but not limited to, developing and expanding our direct sales force and distribution channels through local third-party distributors. In addition, we continually evaluate and explore strategic opportunities as they arise, including product, technology, business or asset transactions, such as acquisitions or divestitures. For example, in July 2013, we acquired an LED components production line and related technology from certain third parties, and we believe this acquisition should allow us to expand our production capacity for LED components, and strengthen our product portfolio, technology and know-how related to LED components.

Recent Developments

Beginning in our fiscal 2014, in response to challenging business conditions and to improve our overall cost competitiveness and cash flow generation, we have initiated actions to accelerate operating cost reductions and improve operational efficiencies. In January 2014, we announced the relocation and consolidation of our manufacturing operations at Sinwu, Taiwan, or Sinwu Facility, to other of our existing facilities. In accordance with the lease agreement with Luxxon Technology Corporation for our Sinwu Facility, we provided a six-month written notice to terminate the lease effective from July 15, 2014. In connection with the closing and relocation of our Sinwu Facility, we are building out existing space in the building we own at Chu-Nan, Hsinchu Science Park. We are also conducting an ongoing review of our staffing requirements and structure, such as eliminating duplicate administrative and support functions, reassigning resources to align with our business strategies, and reducing headcount as appropriate. As a result of the relocation of our Sinwu Facility, realignment of our facilities and ongoing cost reduction efforts, we have experienced workforce reductions, which resulted in severance payments of approximately \$0.2 million in the third quarter of our fiscal 2014. Because we will cease using the Sinwu Facility effective from July 15, 2014, we shortened the useful lives of leasehold improvements resulting in an accelerated charge of depreciation during the three months ended May 31, 2014 of approximately \$0.3 million. These charges were included in the cost of revenues during the three months ended May 31, 2014. We have incurred capital expenditures to expand our Chu-Nan facility and expect to continue to incur costs and expenses associated with these planned activities in the

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near term. For example, we started the relocation activities in July 2014 and the costs to relocate equipment and other assets from the Sinwu Facility to our other facilities will be expensed as incurred. We expect to substantially complete these activities in the fourth quarter of our fiscal 2014. We are currently starting up the equipment moved from the Sinwu Facility to the new area of our Chu-Nan facility and are experiencing a temporary production interruption in the fourth quarter of our fiscal 2014, which could affect our margins and operating results. Starting in the first quarter of our fiscal 2015, we expect to realize the benefits of operating cost reductions, such as savings on lease and overhead costs related to the Sinwu Facility, workforce reductions and normal attrition, and improvement in operational efficiencies through the consolidation of facilities.

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In the third quarter of our fiscal 2014, we began to ramp up the additional LED components production line that we acquired in July 2013 and generate revenues. We are still developing and expanding our LED components business, and we plan to continue to focus on increasing such sales in the future.

Critical Accounting Policies and Estimates

There have been no material changes in the matters for which we make critical accounting policies and estimates in the preparation of our unaudited interim condensed consolidated financial statements for the nine months ended May 31, 2014 as compared to those disclosed in our 2013 Annual Report.

Exchange Rate Information

We are a Delaware corporation and, under SEC requirements, must report our financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. At the same time, our subsidiaries use the local currency as their functional currency. For example, the functional currency for Taiwan SemiLEDs is the NT dollar. The assets and liabilities of the subsidiaries are, therefore, translated into U.S. dollars at exchange rates in effect at each balance sheet date, and income and expense accounts are translated at average exchange rates during the period. The resulting translation adjustments are recorded to a separate component of accumulated other comprehensive income (loss). Any gains and losses from transactions denominated in currencies other than their functional currencies are recognized in the consolidated statements of operations as a separate component of other income (expense). Due to exchange rate fluctuations, such translated amounts may vary from quarter to quarter even in circumstances where such amounts have not materially changed when denominated in their functional currencies.

The translations from NT dollars to U.S. dollars were made at the exchange rates as set forth in the statistical release of the Bank of Taiwan. On August 30, 2013, the exchange rate was 29.93 NT dollars to one U.S. dollar. On May 30, 2014, the exchange rate was 29.99 NT dollars to one U.S. dollar. On July 7, 2014, the exchange rate was 29.92 NT dollars to one U.S. dollar.

The following table sets forth, for the periods indicated, information concerning the number of NT dollars for which one U.S. dollar could be exchanged.

	Average(1)	NT dollars per U.S. dollar		Period-End
		High	Low	
Fiscal 2012	29.86	30.68	28.95	29.93
Fiscal 2013	29.57	30.20	28.95	29.93
September 2013	29.68	29.83	29.54	29.57
October 2013	29.41	29.51	29.36	29.40
November 2013	29.52	29.61	29.40	29.59
December 2013	29.73	30.00	29.56	29.81
January 2014	30.11	30.38	29.92	30.29
February 2014	30.30	30.34	30.24	30.30

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March 2014	30.39	30.60	30.24	30.47
April 2014	30.20	30.36	29.98	30.20
May 2014	30.12	30.17	29.99	29.99
June 2014	29.99	30.05	29.87	29.87
July 2014 (through July 7, 2014)	29.88	29.92	29.85	29.92

(1) Annual averages calculated from month-end rates and monthly averages calculated from daily closing rates.

No representation is made that the NT dollar or U.S. dollar amounts referred to herein could have been or could be converted into U.S. dollars or NT dollars, as the case may be, at any particular rate or at all.

Table of Contents**Results of Operations****Three Months Ended May 31, 2014 Compared to the Three Months Ended May 31, 2013**

	Three Months Ended May 31,		2013		Change \$	Change %
	2014	% of Revenues	\$ (in thousands)	% of Revenues		
LED chips	\$ 1,196	26%	\$ 990	28%	\$ 206	21%
LED components	1,847	40%	1,517	43%	330	22%
Lighting products	1,041	23%	873	25%	168	19%
Other revenues	531	11%	146	4%	385	264%
Total revenues, net	4,615	100%	3,526	100%	1,089	31%
Cost of revenues	7,408	161%	8,083	229%	(675)	(8)%
Gross loss	\$ (2,793)	(61)%	\$ (4,557)	(129)%	\$ 1,764	(39)%

Revenues, net

Our revenues increased by approximately 31% from \$3.5 million for the three months ended May 31, 2013 to \$4.6 million for the three months ended May 31, 2014. The \$1.1 million increase in revenues reflects a \$0.4 million increase in other revenues, a \$0.3 million increase in revenues attributable to the sales of LED components, a \$0.2 million increase in revenues attributable to the sales of LED chips and a \$0.2 million increase in the sales of lighting products.

Revenues attributable to the sales of our LED chips represented 26% and 28% of our revenues for the three months ended May 31, 2014 and 2013, respectively. The increase in revenues attributable to the sales of LED chips was due to a 36% increase in the volume of LED chips sold, primarily due to sales of new lower-priced LED chips. The volume increase, however, was offset in part by a 10% decrease in the average selling price of LED chips, primarily reflecting sales of the lower-priced LED chips.

Revenues attributable to the sales of our LED components represented 40% and 43% of our revenues for the three months ended May 31, 2014 and 2013, respectively. The increase in revenues attributable to the sales of LED components was due to a 53% increase in the volume of LED components sold, offset in part by a 19% decrease in the average selling price of LED components. The volume of LED components sold increased, as we began to ramp up our LED components business. The decrease in the average selling price of LED components resulted from continued market downward pricing pressure.

Revenues attributable to the sales of lighting products represented 23% and 25% of our revenues for the three months ended May 31, 2014 and 2013, respectively. The increase in revenues attributable to the sales of lighting products was primarily due to higher sales and customer demand for our LED luminaires. We believe that our revenues increased in part from recent government initiatives in the United States that promote the use of high efficacy LED lighting.

The increase in other revenues was primarily due to the sales of scrap and raw materials, and the provision of services.

Table of Contents**Cost of Revenues**

Despite higher revenues, our cost of revenues decreased by 8% from \$8.1 million for the three months ended May 31, 2013 to \$7.4 million for the three months ended May 31, 2014. Our cost of revenues was higher during the three months ended May 31, 2013 due to the significant volume of LED chips sold as a result of inventory clearance. The decrease in cost of revenues was also due to lower inventory write-downs, which decreased from \$1.1 million for the three months ended May 31, 2013 to \$0.9 million for the three months ended May 31, 2014.

Gross Loss

Our gross loss decreased from a loss of \$4.6 million for the three months ended May 31, 2013 to a loss of \$2.8 million for the three months ended May 31, 2014. Our gross margin percentage was negative 61% for the three months ended May 31, 2014, as compared to negative 129% for the three months ended May 31, 2013, primarily as a consequence of the significant increase in revenues, as more fully described above. Our sales of a significant volume of LED chips at discounted prices during the three months ended May 31, 2013 had also negatively impacted on our gross margin percentage for the three months ended May 31, 2013.

Operating Expenses

	Three Months Ended May 31,		2013		Change \$	Change %
	2014	% of Revenues	\$	% of Revenues		
	\$		\$			
			(in thousands)			
Research and development	\$ 1,025	22%	\$ 1,146	33%	\$ (121)	(11)%
Selling, general and administrative	2,530	55%	2,171	62%	359	17%
Goodwill impairment			1,077	31%	(1,077)	(100)%
Impairment of long-lived assets			851	24%	(851)	(100)%
Total operating expenses	\$ 3,555	77%	\$ 5,245	149%	\$ (1,690)	(32)%

Research and development. Our research and development expenses decreased from \$1.1 million for the three months ended May 31, 2013 to \$1.0 million for the three months ended May 31, 2014. The decrease was primarily due to a \$0.1 million decrease in salary-related expenses (including stock-based compensation expenses), mainly attributable to employee attrition and reassignment to other functions.

Selling, general and administrative. Our selling, general and administrative expenses increased from \$2.2 million for the three months ended May 31, 2013 to \$2.5 million for the three months ended May 31, 2014. The increase was mainly attributable to a \$0.3 million increase in professional service expenses, mainly for legal and advisory services, primarily due to our defense of a putative class action lawsuit, which was closed in February 2014, our increased use of outside legal counsel to assist with general corporate matters, legal expenses associated with patents, and costs related to our hiring of a consultant to assist with market intelligence and channel development for a new market.

Goodwill impairment. During the three months ended May 31, 2013, we recognized a \$1.1 million impairment charge on goodwill that arose from our acquisition of a 51% equity interest in Ning Xiang in August 2011, as more fully described in Note 3 in the Notes to the Unaudited Condensed Consolidated Financial Statements of this Quarterly Report.

Impairment of long-lived assets. During the three months ended May 31, 2013, we recognized a \$0.9 million impairment charge on the intangible asset for customer relationships that arose from our acquisition of a 51% equity interest in Ning Xiang in August 2011, as more fully described in Note 3 in the Notes to the Unaudited Condensed Consolidated Financial Statements of this Quarterly Report.

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Other Income (Expenses)

	2014	Three Months Ended May 31,	2013
\$			