SemiLEDs Corp
Form 10-Q
July 12, 2011
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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, 2011

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

(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 o No o

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 27,261,497 shares of common stock, par value $0.0000056 per share, outstanding as of July 7, 2011.

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SEMILEDS CORPORATION

FORM 10-Q for the Quarter Ended May 31, 2011

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

SEMILEDS CORPORATION

Consolidated Balance Sheets

(Unaudited)

(In thousands, except for per share amounts)

		May 31, 2011		August 31, 2010
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$	94,392	$	13,520
Accounts receivable, net of allowance for doubtful accounts of $168 and $101		7,227		7,620
Accounts receivable from related parties		713		73
Inventory		18,413		11,362
Prepaid expenses and other current assets		1,875		2,269
Total current assets		122,620		34,844
Property, plant and equipment, net		47,261		31,929
Intangible assets, net		456		380
Investments in unconsolidated entities		16,124		15,961
Other assets		1,030		792
TOTAL ASSETS	$	187,491	$	83,906
LIABILITIES AND STOCKHOLDERS EQUITY				
CURRENT LIABILITIES:				
Accounts payable	$	2,143	$	2,814
Accrued liabilities		4,751		4,355
Deferred income, current portion		51		
Long-term debt, current portion		3,907		1,752
Total current liabilities		10,852		8,921
Long-term debt, net of current portion		6,572		3,786
Deferred income, net of current portion		463		
Total liabilities		17,887		12,707
Commitments and contingencies (Note 6)				
STOCKHOLDERS EQUITY:				
Common stock, $0.0000056 par value 32,143 and 29,071 shares authorized; 27,261 and 7,428 shares issued and outstanding as of May 31, 2011 and August 31, 2010				
Convertible preferred stock issuable in Series A to E, $0.0000056 par value zero and 13,719 shares authorized; zero and 13,719 shares issued and outstanding as of May 31, 2011 and August 31, 2010				
Additional paid-in capital		163,953		70,510
Accumulated other comprehensive income (loss)		6,992		(441)
Retained earnings (accumulated deficit)		(1,341)		1,130
Total stockholders equity		169,604		71,199

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	187,491	$	83,906

See notes to unaudited consolidated financial statements.

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SEMILEDS CORPORATION

Consolidated Statements of Operations

(Unaudited)

(In thousands, except for per share amounts)

	Three Months Ended May 31, 2011	Three Months Ended May 31, 2010	Nine Months Ended May 31, 2011	Nine Months Ended May 31, 2010
Revenues, net	$ 5,600	$ 9,886	$ 28,573	$ 24,275
Cost of revenues	5,124	4,846	19,128	14,230
Gross profit	476	5,040	9,445	10,045
Operating expenses:				
Research and development	1,041	582	2,226	1,490
Selling, general and administrative	3,329	919	6,814	2,244
Total operating expenses	4,370	1,501	9,040	3,734
Income (loss) from operations	(3,894)	3,539	405	6,311
Other income (expense):				
Loss from unconsolidated entities	(1,105)	(159)	(2,002)	(169)
Interest income (expense), net	8	(10)	10	(21)
Other income, net	39		83	
Foreign currency transaction gain (loss), net	(181)	27	(920)	(325)
Total other expense, net	(1,239)	(142)	(2,829)	(515)
Income (loss) before income taxes	(5,133)	3,397	(2,424)	5,796
Income tax expense (benefit)	(10)	151	47	271
Net income (loss)	$ (5,123)	$ 3,246	$ (2,471)	$ 5,525
Net income (loss) attributable to common shareholders:				
Basic	$ (5,123)	$ 640	$ (5,541)	$ 460
Diluted	$ (5,123)	$ 678	$ (5,541)	$ 487
Net income (loss) per share attributable to common shareholders:				
Basic	$ (0.19)	$ 0.09	$ (0.28)	$ 0.07
Diluted	$ (0.19)	$ 0.09	$ (0.28)	$ 0.06
Shares used in computing net income (loss) per share attributable to common shareholders (Note 8):				
Basic	27,256	7,111	20,021	7,002
Diluted	27,256	7,873	20,021	7,707

See notes to unaudited consolidated financial statements.

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SEMILEDS CORPORATION

Consolidated Statement of Stockholders Equity and Comprehensive Income (Loss)

(Unaudited)

(In thousands)

	Common Stock Shares	Common Stock Amount	Convertible Preferred Stock Shares	Convertible Preferred Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders Equity
BALANCE August 31, 2010	7,428	$	13,719	$	$ 70,510	$ (441)	$ 1,130	$ 71,199
Issuance of common stock upon exercise of stock options	76				62			62
Issuance of common stock upon the completion of offering, net of issuance costs	6,038				91,993			91,993
Conversion into common stock	13,719		(13,719)					
Stock-based compensation					1,388			1,388
Comprehensive income (loss):								
Foreign currency translation adjustment						7,433		7,433
Net loss							(2,471)	(2,471)
Total comprehensive income								4,962
BALANCE May 31, 2011	27,261	$		$	$ 163,953	$ 6,992	$ (1,341)	$ 169,604

See notes to unaudited consolidated financial statements.

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SEMILEDS CORPORATION

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Nine Months Ended May 31, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (2,471)	$ 5,525
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,759	3,367
Stock-based compensation expense	1,388	100
Bad debt expense	50	185
Gain on disposal of property, plant and equipment		(15)
Loss from unconsolidated entities	2,002	169
Income recognized on patents assignment	(4)	
Changes in operating assets and liabilities:		
Accounts receivable, net	617	(3,413)
Inventory	(5,572)	(1,530)
Prepaid expenses and other	(601)	167
Accounts payable	(510)	1,165
Accrued liabilities	317	373
Net cash provided by (used in) operating activities	(25)	6,093
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(16,490)	(6,130)
Sale of property, plant and equipment		40
Purchase of investments	(993)	(15,532)
Payments for development of intangible assets	(171)	(134)
Acquisition, net of cash acquired		(919)
Proceeds from patents assignment, net	540	
Other investing activities, net	(98)	47
Net cash used in investing activities	(17,212)	(22,628)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net of issuance costs	92,702	
Proceeds from issuance of Series E convertible preferred stock		15,043
Proceeds from exercise of stock options	62	165
Proceeds from line of credit	3,304	1,413
Payments on line of credit	(1,425)	(1,126)
Proceeds from long-term debt	2,896	1,481
Payments of long-term debt	(642)	(339)
Net cash provided by financing activities	96,897	16,637
Effect of exchange rate changes on cash and cash equivalents	1,212	340
NET INCREASE IN CASH AND CASH EQUIVALENTS	80,872	442
CASH AND CASH EQUIVALENTS Beginning of period	13,520	13,715
CASH AND CASH EQUIVALENTS End of period	$ 94,392	$ 14,157
NONCASH INVESTING ACTIVITIES:		
Accrual related to property, plant and equipment	$ 560	$ 659

See notes to unaudited consolidated financial statements.

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SEMILEDS CORPORATION

Notes to Consolidated Financial Statements

(Unaudited)

1. Business

Business SemiLEDs Corporation (SemiLEDs) was established on January 4, 2005 as a Delaware corporation. As of May 31, 2011, SemiLEDs had three wholly owned subsidiaries. The most significant of these is SemiLEDs Optoelectronics Co., Ltd., formerly Semi-Photonics, (Taiwan SemiLEDs), which is located in Hsinchu, Taiwan where substantially all research, development, manufacturing, marketing and sales activities take place and where substantially all of the assets are held.

The following chart illustrates the relationship and ownership percentages of SemiLEDs corporate structure and joint venture entities:

SemiLEDs and its subsidiaries (collectively, the Company) develop, manufacture and sell high performance light emitting diodes (LEDs). The Company s customers are primarily located in Asia, Russia and North America.

Initial Public Offering On December 8, 2010, the Company sold 5,250 thousand shares of common stock at a price of $17.00 per share in an initial public offering. The shares began trading on the NASDAQ Global Market on December 8, 2010. Also, on December 9, 2010, the Company s underwriters exercised their overallotment option to purchase another 788

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thousand shares of common stock. The $95.5 million in net proceeds from the initial public offering, before deducting offering-related expenses of $3.5 million, were received on December 14, 2010, which was the closing date of the offering. Upon the completion of the initial public offering on December 8, 2010, all outstanding shares of convertible preferred stock converted into common stock on a one-for-one basis, as adjusted for the 14-for-1 reverse stock split described below, and shares of convertible preferred stock are no longer authorized to be issued. The convertible preferred stock converted into 13,719 thousand shares of common stock and the Class B common stock converted into 661 thousand shares of common stock. Concurrently, the Company increased the number of authorized shares of common stock to 32,143 thousand with a par value of $0.0000056 per share.

Reverse Stock Split On November 13, 2010, the Company s Board of Directors approved an Amended and Restated Certificate of Incorporation to affect a 14-to-1 reverse stock split of the Company s common and convertible preferred stock, subject to shareholder consent. This reverse stock split became effective upon shareholder approval and filing of the Amended and Restated Certificate of Incorporation. Accordingly, the common and convertible preferred stock authorized and outstanding, par values, stock option disclosures, net income per share amounts, and other per share disclosures for all periods presented have been adjusted to reflect the impact of this reverse stock split.

2. Summary of Significant Accounting Policies

Basis of Presentation The Company s unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (US GAAP) and applicable provisions of the Securities and Exchange Commission (SEC) regarding interim financial reporting and include the accounts of SemiLEDs and its consolidated subsidiaries. All intercompany transactions and balances have been eliminated during consolidation. Certain information and note disclosures normally included in the financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s prospectus filed pursuant to Rule 424(b) under the Securities Act of 1933, with the SEC on December 9, 2010. The consolidated balance sheet as of August 31, 2010, included herein, was derived from the audited consolidated financial statements as of that date.

The unaudited interim 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 statement of financial position as of May 31, 2011, the Company s results of operations for the three and nine months ended May 31, 2011 and 2010, and its cash flows for the nine months ended May 31, 2011 and 2010. The results for the three or nine months ended May 31, 2011 are not necessarily indicative of the results to be expected for the year ending August 31, 2011. All references to May 31, 2011 or to the three or nine months ended May 31, 2011 and 2010 in the notes to the consolidated financial statements are unaudited.

Use of Estimates The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Such management estimates include collectability of accounts receivable, inventory net realizable values, realization of deferred tax assets, valuation of stock-based compensation expense, and recoverability of the carrying amounts of property, plant and equipment and intangible assets. The 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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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. The loss of any of these suppliers may cause the Company to incur additional transition costs, result in delays in the manufacturing and delivery of its products, or cause it to carry excess or obsolete inventory. The Company relies on a limited number of third parties for the fulfillment of its customer orders, and the failure of these third parties to perform could have an adverse effect upon the Company s reputation and its ability to distribute its products, 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 with prominent banks and invests only in high-quality fixed income securities. Deposits held with banks may exceed the amount of insurance provided on such deposits.

As of May 31, 2011 and August 31, 2010, cash of $75.3 million and $0.6 million, respectively, comprising U.S. dollar denominated bank deposits held in uninsured accounts at a major financial institution located in the United States. As of May 31, 2011 and August 31, 2010, cash of $19.1 million and $12.9 million, respectively, was held in uninsured accounts at major financial institutions located in Taiwan, and such cash balance included U.S. dollar denominated bank deposits of $17.4 million and $12.3 million, respectively. Management believes that these major financial institutions are of high credit quality.

Substantially all of the Company s revenues are 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 markets in Asia, particularly in China and Taiwan. Management performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable. Management evaluates the need for a reserve 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.

During the three and nine months ended May 31, 2011, sales to the top ten customers represented 70% and 58% of the Company s net revenues and during the three and nine months ended May 31, 2010, sales to top ten customers represented 63% and 64% of net revenues.

Net revenues generated from sales to customers in China (including Hong Kong) and Taiwan accounted for 71% and 69% of the Company s net revenues during the three and nine months ended May 31, 2011, and 81% and 83% during the three and nine months ended May 31, 2010.

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3. Balance Sheet Components

Inventory

Inventory as of May 31, 2011 and August 31, 2010 consists of the following (in thousands):

	May 31, 2011	August 31, 2010
Raw materials	$ 3,388	$ 2,610
Work in process	4,680	3,955
Finished goods	10,345	4,797
Inventory	$ 18,413	$ 11,362

Inventory write-downs to estimated net realizable values during the three months and nine months ended May 31, 2011 were $1.1 million and $1.5 million, respectively.

Property, Plant and Equipment, net

Property, plant and equipment as of May 31, 2011 and August 31, 2010 consists of the following (in thousands):

	May 31, 2011	August 31, 2010
Buildings and improvements	$ 12,998	$ 7,148
Machinery and equipment	46,527	32,492
Leasehold improvements	3,042	2,225
Other equipment	1,698	1,230
Construction in progress	6,478	5,561
Total property, plant and equipment	70,743	48,656
Less accumulated depreciation and amortization	(23,482)	(16,727)
Property, plant and equipment, net	$ 47,261	$ 31,929

4. Investments in Unconsolidated Entities

The Company s unconsolidated entities are joint ventures and privately-held companies that the Company accounts for as investments on an equity or cost method basis. The equity method investments consist of SILQ (Malaysia) Sdn. Bhd. (SILQ), Xurui Guangdian Co., Ltd. (China

SemiLEDs), and SS Optoelectronics Co., Ltd. (SS Optoelectronics). The Company s ownership interest and investments in unconsolidated entities as of May 31, 2011 and August 31, 2010 consist of the following (in thousands, except for percentages):

	Percentage Ownership	May 31, 2011	August 31, 2010
Equity method investments:			
SILQ	50%	$ 895	$ 433
China SemiLEDs	49%	13,915	14,575
SS Optoelectronics	49%	253	239
Cost method investments	Various	1,061	714
Total investments in unconsolidated entities		$ 16,124	$ 15,961

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There have been no dividends received from unconsolidated entities through May 31, 2011.

Equity Method Investments The following joint ventures are partially owned by the Company or its wholly-owned subsidiaries, however, the Company has determined that it does not control the entities but can exercise significant influence over the operating and financial policies of the joint ventures. The Company accounts for these joint ventures using the equity method of accounting.

In September 2009, the Company, through a wholly owned subsidiary, contributed $570,000 to form SILQ, a joint venture in Malaysia. In April 2011, the Company participated in SILQ s capital increase and contributed $662,000. The Company and the other investor in the joint venture each hold a 50% ownership and voting interest in SILQ s common stock. The Company entered into the joint venture agreement that established SILQ to design, manufacture and sell lighting fixtures and systems.

In December 2009, the Company entered into an agreement to establish China SemiLEDs in Guangdong, China for the purposes of conducting research and development and producing LED epitaxial wafers and chips to be sold in China. The Company contributed $14.7 million to acquire a 49% ownership interest in China SemiLEDs.

In December 2009, the Company, through a wholly owned subsidiary, entered into an agreement to contribute $980,000 for a 49% ownership interest in SS Optoelectronics, a joint venture in Taiwan. The investment is payable based upon a payment schedule set forth in the agreement as follows: $245,000 upon signing the agreement, $245,000 after the incorporation of the joint venture and $490,000 upon reaching a certain sales level. As of May 31, 2011, the Company has contributed $245,000. The Company entered into the joint venture agreement that established SS Optoelectronics to facilitate sales of the Company s LED chips to the other investor in the joint venture. However, the application for entry into the Hsinchu Science Park was rejected by the Hsinchu Science Park Administration because the main purpose of SS Optoelectronics was not for research and development or manufacturing as required under the regulations of the Administration. As such, the Company made a determination to dissolve the joint venture in accordance with the joint venture agreement and sent a notice of termination to the other investor in November 2010. Management does not expect that dissolving this joint venture will have a material impact on the Company s consolidated financial statements.

The excess of the Company s share of net assets of China SemiLEDs over book value is $7.2 million at May 31, 2011. This difference is associated with the investee s tangible assets ands being amortized over the weighted average useful life of the assets of 11 years beginning in the period those assets are put in place and ready for their intended use, which was April 2011.

The aggregate fair value of the Company s investments in the non-marketable stock of its equity method investees is not readily available. These investments are assessed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

The following is a summary of the financial information for China SemiLEDs (in thousands):

	May 31, 2011	May 31, 2010
Current assets	$ 22,913	$ 27,543
Noncurrent assets	60,488	17,341
Current liabilities	17,322	45
Noncurrent liabilities	22,904	
Stockholders equity	43,175	44,839

	Nine Months Ended May 31, 2011	Nine Months Ended May 31, 2010
Revenues, net	$ 43	$
Gross profit	(1,301)	
Loss from operations	(4,369)	(151)
Net loss	(3,754)	(126)

Cost Method Investments In January 2011, the Company, through a wholly owned subsidiary, invested $331,000 in LumenMax Optoelectronics Co., Ltd., a privately-held company that develops and manufactures LED products, acquiring a 4% ownership interest in LumenMax. The Company accounts for its investment in LumenMax under the cost method of accounting because the Company cannot exercise significant influence over the operating and financial policies of LumenMax.

As of May 31, 2011, the Company held investments in nonmarketable common stock of four unaffiliated companies with a carrying amount of $1.1 million.

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As of August 31, 2010, the Company held investments in nonmarketable common stock of three unaffiliated companies with a carrying amount of $714,000.

The fair value of these investments is not readily available. These investments are assessed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

5. Deferred Income

In March 2011, the Company received a one-time payment of $540,000, net of related costs of $60,000 for the assignment of 13 patents to China SemiLEDs pursuant to a patent assignment and license agreement. In addition, China SemiLEDs has granted the Company a royalty-free, transferable and exclusive license to use the assigned patents globally except in manufacturing LED wafers and chips in China and agreed to license all future patents acquired by China SemiLEDs to the Company for the use in manufacturing or selling LED products globally. Income of $509,000 on such assignment was initially deferred and will be recognized in other income over the life of the assigned patents. For the three months ended May 31, 2011, the Company recognized $4,000 in other income.

6. Commitments and Contingencies

Operating Lease Agreements The Company has several operating leases with unrelated parties, primarily for land, plant and office space in Taiwan, which are noncancellable and which expire on November 30, 2016 and December 31, 2020. Lease expense related to these noncancellable operating leases was $216,000 and $198,000 during the three months ended May 31, 2011 and 2010 and $561,000 and $431,000 during the nine months ended May 31, 2011 and 2010. Lease expense is recognized on a straight-line basis over the term of the lease. The aggregate future noncancellable minimum rental payments for the Company s operating leases as of May 31, 2011 consist of the following (in thousands):

Years Ending August 31,		**Operating Leases**
2011 (remainder)	$	180
2012		705
2013		756
2014		764
2015		842
Thereafter		1,388
Total	$	4,635

Purchase Obligations The Company had purchase commitments for equipment in the amount of $12.6 million and $6.9 million as of May 31, 2011 and August 31, 2010.

Litigation The Company is subject to various claims arising in the ordinary course of business.

On October 14, 2010, Cree, Inc., or Cree, a competitor and a major manufacturer of LED products, filed a complaint against the Company in the United States District Court of Delaware asserting infringement of certain of their patents. The complaint seeks injunctive relief, unspecified monetary damages, pre- and post-judgment interest and attorneys fees. The Company filed an answer to the complaint on November 3, 2010, denying all allegations of infringement. Cree filed a motion on December 10, 2010 to amend its initial complaint to add additional United States patents that it alleges the Company has infringed. On March 22, 2011, the Court granted Cree s motion to amend and the second amended complaint was placed on file. Cree then filed a third amended complaint, based on the same Cree patents and adding a subsidiary of the Company as a defendant. The third amended complaint similarly alleges that the Company has infringed certain of Cree s patents in the United States and seeks injunctive relief, unspecified monetary damages, pre- and post-judgment interest and attorneys fees. The Company answered the third amended complaint on May 16, 2011, denying all allegations of infringement. Management believes that the Company has meritorious defenses and the Company intends to contest this lawsuit vigorously. However, in the event that Cree is successful in obtaining some or all of the relief it seeks, it could have a material adverse effect on the Company s business and reputation. At this time, management is unable to estimate the potential financial impact this action could have on the Company.

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In August 2009, Gertrude F. Neumark Rothschild, a retired professor from the United States, filed a complaint with the Intellectual Property Court in Taiwan against the Company and seven other companies, asserting that the production process the Company uses to manufacture our LED chips infringes her patent in Taiwan. Mr. Trung T. Doan, the Company s chief executive officer, was named a co-defendant. In the complaint, Ms. Rothschild seeks monetary damages and an injunction against future infringement. She alleges that the Company and Mr. Trung T. Doan are jointly and severally liable. On June 30, 2010, the complaint was dismissed by the court and on July 30, 2010, Ms. Rothschild appealed the decision. On October 28, 2010, a pleading was filed with the Intellectual Property Court in Taiwan by Ms. Rothschild s attorneys to withdraw her claim for an injunction against future infringement of her patent because such patent had expired on August 15, 2009. On May 18, 2011, the Intellectual Property Court granted a motion filed by Diana Parker who, as the estate administrator of Ms. Rothschild, has substituted Ms. Rothschild as the appellant and continues to seek initial monetary damages of NT33.0 million (approximately $1.1 million), although the ultimate amount of the damages if she were to prevail on appeal is unpredictable and has not yet been determined. Management believes that the Company has meritorious defenses and the Company intends to contest this lawsuit vigorously.

Third parties have from time to time claimed, and others may claim in the future, that the Company has infringed their past, current or future intellectual property rights. These claims, whether meritorious or not, could be time-consuming, result in costly litigation, require expensive changes in the Company s methods of doing business or could require the Company to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm the Company s business, operating results, cash flows and financial position.

Indemnifications Under the indemnification provisions of certain of the Company s distributor agreements, the Company agrees to defend the distributors against third-party intellectual property infringement claims. To date, there have been no material claims under such indemnification provisions.

7. Stock-based Compensation

As of August 31, 2010, the Company had one stock-based compensation plan (the 2005 Plan). In November 2010, the Company s Board of Directors and its stockholders approved the 2010 Equity Inventive Plan (the 2010 Plan), discussed further below, which became effective upon the completion of the initial public offering on December 8, 2010.

The Company s stock-based compensation expense was $848,000 and $81,000 during the three months ended May 31, 2011 and 2010. The total stock-based compensation expense consists of stock-based compensation expense for stock options and restricted stock awards granted to employees of $466,000 and $56,000, and directors of $353,000 and zero during the three months ended May 31, 2011 and 2010. Stock-based compensation also includes $29,000 and $25,000 during the three months ended May 31, 2011 and 2010 for Series E shares issued, which were converted into common stock on a one-for-one basis, as part of an employment agreement related to the Company s acquisition of SBDI.

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The Company s stock-based compensation expense was $1,388,000 and $100,000 during the nine months ended May 31, 2011 and 2010. The total stock-based compensation expense consists of stock-based compensation expense for stock options and restricted stock awards granted to employees of $782,000 and $75,000, nonemployees of $15,000 and zero, and directors of $492,000 and zero during the nine months ended May 31, 2011 and 2010. Stock-based compensation also includes $99,000 and $25,000 during the nine months ended May 31, 2011 and 2010 for Series E shares issued, which were converted into common stock on a one-for-one basis, as part of an employment agreement related to the Company s acquisition of SBDI.

Equity Incentive Plans A total of 3,849 thousand shares of common stock was reserved for issuance under the 2005 Plan and 2010 Plan. After the initial public offering, awards shall be made from the 2010 Plan. The 2010 Plan 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. Options outstanding under the 2005 Plan will continue to be governed by its existing terms.

On January 20, 2011, the Company s board of directors approved the granting of options for 293 thousand shares of the Company s common stock and 222 thousand stock units to its 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 service termination. In addition, the Company s board of directors also approved the granting of 71 thousand stock units to its directors that vest 100% on the first anniversary of the vesting start date. The exercise price of the stock options is $19.00, which equals to the closing price of the Company s common stock on the grant date. The grant-date fair value of the stock units is $19.00 per unit.

On March 31, 2011, the Company s board of directors approved the granting of options for 3 thousand shares of the Company s common stock and 11 thousand stock units to its 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 service termination. The exercise price of the stock options is $15.61, which equals to the closing price of the Company s common stock on the grant date. The grant-date fair value of the stock units is $15.61 per unit.

Determining Fair Value of Stock Options For the nine months ended May 31, 2011 and 2010, the fair value of each grant of stock options was determined by the Company using the methods and assumptions discussed below. Each of these inputs is subjective and generally requires significant judgment to determine.

Valuation Method Management estimates the fair value of stock options granted using the Black-Scholes option-pricing model.

Expected Term The expected term represents the period that the Company s stock options are expected to be outstanding. The expected term for options granted to employees of the Company is derived from historical data on employee exercises and post-vesting employment termination behavior after taking into account the contractual life of the award. The expected term for nonemployee options is equal to the contractual life of the option.

Expected Volatility The expected volatility was based on the implied stock volatilities of several of the Company s publicly-traded peers over a period equal to the expected terms of the options as the Company did not have a sufficient trading history to use the volatility of its own common stock.

Fair Value of Common Stock The fair value of the Company s common stock underlying the stock options was based on the trading price of the Company s shares on the date of grant.

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Risk-Free Interest Rate The risk-free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant for zero coupon U.S. Treasury notes with maturities approximately equal to the expected term of the related options.

Expected Dividend The expected dividend has been zero for the Company s option grants as the Company has never paid dividends and does not expect to pay dividends for the foreseeable future.

Determining Fair Value of Stock Units Grant date fair value is based upon the market price of the Company s common stock on the date of the grant. This fair value is amortized to compensation expense over the vesting term.

8. Net Income (Loss) Per Share of Common Stock

The following tables set forth the computation of the Company s basic and diluted net income (loss) per share of common stock for the three and nine months ended May 31, 2011 and 2010 (in thousands, except for per share amounts). The two-class method was used for the period through December 8, 2010, the period that the convertible preferred shares were outstanding.

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	Three Months Ended May 31, 2011	Three Months Ended May 31, 2010	Nine Months Ended May 31, 2011	Nine Months Ended May 31, 2010
Numerator:				
Basic:				
Net income (loss)	$ (5,123)	$ 3,246	$ (2,471)	$ 5,525
8% noncumulative dividends on convertible preferred stock		(1,399)	(1,532)	(4,198)
Undistributed earnings allocated to convertible preferred stock		(1,207)	(1,538)	(867)
Net income (loss) attributable to common shareholders, basic	$ (5,123)	$ 640	$ (5,541)	$ 460
Diluted:				
Net income (loss) attributable to common shareholders, basic	$ (5,123)	$ 640	$ (5,541)	$ 460
Undistributed earnings re-allocated to common stock		38		27
Net income (loss) attributable to common shareholders, diluted	$ (5,123)	$ 678	$ (5,541)	$ 487
Denominator:				
Basic:				