APPLIED OPTOELECTRONICS, INC.
Form 10-Q
August 08, 2017
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

OR

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

For the transition period from __________ to __________

Commission File Number: 001-36083

Applied Optoelectronics, Inc.

(Exact name of registrant as specified in its charter)

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

13139 Jess Pirtle Blvd.

Sugar Land, TX 77478

(Address of principal executive offices)

(281) 295-1800

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 ("Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes 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 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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: as of August 2, 2017 there were 19,303,210 shares of the registrant's Common Stock outstanding.

Table of Contents

Applied Optoelectronics, Inc.

Table of Contents

2

Table of Contents

Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	June 30, 2017	December 31, 2016
ASSETS		
Current Assets		
Cash and cash equivalents	$ 74,825	$ 50,224
Restricted cash	1,054	1,732
Short-term investments	42	44
Accounts receivable - trade, net of allowance of $31 at June 30, 2017 and December 31, 2016, respectively	73,759	49,766
Inventories	59,701	51,817
Notes receivable	—	—
Prepaid expenses and other current assets	9,131	3,969
Total current assets	218,512	157,552
Cash restricted for construction in progress	—	8
Property, plant and equipment, net of accumulated depreciation of $58,596 and $49,175 at June 30, 2017 and December 31, 2016, respectively	165,154	144,098
Land use rights, net	786	778
Intangible assets, net	4,007	3,993
Deferred income tax assets	10,026	11,421
Other assets, net	8,501	4,468
TOTAL ASSETS	$ 406,986	$ 322,318
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of notes payable and long-term debt	$ 4,552	$ 7,865
Accounts payable	53,321	36,375
Bank acceptance payable	—	307
Accrued income taxes	4,947	974
Accrued liabilities	13,850	14,452
Total current liabilities	76,670	59,973
Notes payable and long-term debt, less current portion	22,814	34,961
TOTAL LIABILITIES	99,484	94,934
Stockholders' equity:		

Preferred Stock; 5,000 shares authorized at $0.001 par value; no shares issued and outstanding at June 30, 2017 or December 31, 2016, respectively	—	—
Common Stock; 45,000 shares authorized at $0.001 par value; 19,192 and 18,400 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	19	18
Additional paid-in capital	290,067	265,264
Accumulated other comprehensive gain (loss)	4,369	(885)
Retained earnings (accumulated deficit)	13,047	(37,013)
TOTAL STOCKHOLDERS' EQUITY	307,502	227,384
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 406,986	$ 322,318

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

3

Table of Contents

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Revenue, net	$ 117,371	$ 55,254	$ 213,595	$ 105,676
Cost of goods sold	64,089	37,952	118,841	74,121
Gross profit	53,282	17,302	94,754	31,555
Operating expenses				
Research and development	8,073	7,814	15,505	16,210
Sales and marketing	2,158	1,610	4,061	3,290
General and administrative	8,786	5,906	16,608	11,639
Total operating expenses	19,017	15,330	36,174	31,139
Income from operations	34,265	1,972	58,580	416
Other income (expense)				
Interest income	70	65	105	166
Interest expense	(245)	(450)	(544)	(851)
Other income (expense), net	64	(932)	(544)	(598)
Total other income (expense)	(111)	(1,317)	(983)	(1,283)
Income (loss) before income taxes	34,154	655	57,597	(867)
Income tax (expense) benefit	(5,083)	(52)	(8,737)	140
Net income (loss)	$ 29,071	$ 603	$ 48,860	$ (727)
Net income (loss) per share				
Basic	$ 1.52	$ 0.04	$ 2.59	$ (0.04)
Diluted	$ 1.43	$ 0.03	$ 2.45	$ (0.04)
Weighted average shares used to compute net income (loss) per share:				
Basic	19,081,034	17,090,750	18,840,656	17,010,506
Diluted	20,367,127	17,454,552	19,956,097	17,010,506

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

Table of Contents

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net income (loss)	$ 29,071	$ 603	$ 48,860	$ (727)
(Loss) gain on foreign currency translation adjustment	797	(956)	5,254	(38)
Comprehensive income (loss)	$ 29,868	$ (353)	$ 54,114	$ (765)

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

Table of Contents

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Six months ended June 30, 2017

(Unaudited, in thousands)

	Preferred Stock Number of shares	Preferred Stock Amount	Common Stock Number of shares	Common Stock Amount	Additional paid-in capital	Accumulated other comprehensive gain (loss)	Retained earnings/ (Accumulated deficit)	Stockholders' equity
January 1, 2017	—	$ —	18,400	$ 18	$ 265,264	$ (885)	$ (37,013)	$ 227,384
Public offering of common stock, net	—	—	459	1	21,571	—	—	21,572
Stock options exercised, net of shares withheld for employee tax	—	—	262	—	(176)	—	—	(176)
Issuance of restricted stock, net of shares withheld for employee tax	—	—	71	—	(366)	—	—	(366)
Stock based compensation	—	—	—	—	3,767	—	—	3,767
Cumulative effect of previously unrecognized tax benefits	—	—	—	—	—	—	1,207	1,207
Foreign currency translation adjustment	—	—	—	—	—	5,254	—	5,254
Other	—	—	—	—	7	—	(7)	—
Net income	—	—	—	—	—	—	48,860	48,860
June 30, 2017	—	$ —	19,192	$ 19	$ 290,067	$ 4,369	$ 13,047	$ 307,502

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

Applied Optoelectronics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Six months ended June 30, 2017	2016
Operating activities:		
Net income (loss)	$ 48,860	$ (727)
Adjustments to reconcile net income to net cash provided by operating activities:		
Lower of cost or market adjustment to inventory	675	1,794
Depreciation and amortization	8,929	6,241
Deferred income taxes, net	2,638	—
Loss on disposal of assets	40	85
Share-based compensation	3,767	1,783
Unrealized foreign exchange loss	(254)	767
Changes in operating assets and liabilities:		
Accounts receivable, trade	(23,992)	(2,798)
Inventories	(6,357)	4,743
Other current assets	(4,845)	3,111
Accounts payable	17,481	4,862
Accrued income taxes	3,870	—
Accrued liabilities	(928)	2,276
Net cash provided by operating activities	49,884	22,137
Investing activities:		
Maturities of short-term investments	2	7,749
Change in restricted cash for construction in progress	8	—
Purchase of property, plant and equipment	(26,687)	(33,768)
Proceeds from disposal of equipment	170	755
Deposits and prepaid for equipment	(3,838)	(863)
Purchase of intangible assets	(251)	(283)
Net cash used in investing activities	(30,596)	(26,410)
Financing activities:		
Proceeds from issuance of notes payable and long-term debt	—	24,864
Principal payments of long-term debt and notes payable	(15,911)	(2,200)
Proceeds from line of credit borrowings	—	71,981
Repayments of line of credit borrowings	—	(75,243)
Proceeds from bank acceptance payable	—	3,501
Repayments of bank acceptance payable	(307)	(3,995)
Repayments of note payable	—	(500)
Decrease (increase) in restricted cash	742	(271)
Exercise of stock options	1,301	219
Payments of tax withholding on behalf of employees related to share-based compensation	(1,843)	—

Proceeds from common stock offering, net	21,572	—
Net cash provided by financing activities	5,554	18,356
Effect of exchange rate changes on cash	(241)	132
Net increase in cash	24,601	14,215
Cash and cash equivalents at beginning of period	50,224	28,074
Cash and cash equivalents at end of period	$ 74,825	$ 42,289
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest	$ 539	$ 443
Income taxes	2,226	1
Non-cash investing and financing activities:		
Net change in accounts payable related to property and equipment additions	535	—

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

Table of Contents

Applied Optoelectronics, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Description of Business

Business Overview

Applied Optoelectronics, Inc., (“AOI” or the “Company”) was incorporated in Texas on February 28, 1997. In March 2013, the Company converted into a Delaware corporation. The Company is a leading, vertically integrated provider of fiber-optic networking products, primarily for four networking end-markets: internet data center, cable television, fiber-to-the-home and telecommunications. The Company designs and manufactures a wide range of optical communications products at varying levels of integration, from components, subassemblies and modules to complete turn-key equipment.

The Company has manufacturing and research and development facilities located in the U.S., Taiwan and China. At its corporate headquarters and manufacturing facilities in Sugar Land, Texas, the Company primarily manufactures lasers and laser components and performs research and development activities for laser component and optical module products. The Company operates in Taipei, Taiwan and Ningbo, China through its wholly-owned subsidiary Prime World International Holdings, Ltd. (“Prime World”, incorporated in the British Virgin Islands) Prime World is the parent of Global Technology, Inc. (“Global”, incorporated in the People’s Republic of China). Through Global, the Company primarily manufactures certain of our data center transceiver products, including subassemblies, as well as Cable TV Broadband (“CATV”) systems and equipment, and performs research and development activities for the CATV products. Prime World also operates a branch in Taiwan, which primarily manufactures transceivers. The Company also has a research and development center in Lawrenceville, Georgia.

Interim Financial Statements

The unaudited condensed consolidated financial statements of the Company as of June 30, 2017 and December 31, 2016 and for the three and six months ended June 30, 2017 and June 30, 2016, have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim information and with the instructions on Form 10-Q and Rule 10-01 of Regulation S-X pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In accordance with those rules and regulations, the Company has omitted certain information and notes required by GAAP for annual consolidated financial statements. In the opinion of management, the condensed consolidated financial statements contain all adjustments, except as otherwise noted, necessary for the fair presentation of the Company's financial position and results of operations for the periods presented. The year-end condensed balance sheet data was derived from audited financial statements. These condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K ("Annual Report") for the fiscal year ended December 31, 2016. The results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

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

Note 2. Significant Accounting Policies

There have been no changes in the Company's significant accounting policies for the three and six months ended June 30, 2017, as compared to the significant accounting policies described in its 2016 Annual Report, except as described below.

Table of Contents

Recent Accounting Pronouncements

Recent Accounting Pronouncements Adopted in 2017

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, to simplify several aspects of accounting for share-based payment transactions, including the following areas: accounting for excess tax benefits and tax deficiencies; classifying excess tax benefits on the statement of cash flows; accounting for forfeitures; classifying awards that permit share repurchases to satisfy statutory tax withholding requirements; classifying tax payments on behalf of employees on the statement of cash flows; and, for nonpublic entities only, determining the expected term and electing the intrinsic value measurement alternative for stock option awards. The guidance is effective for public business entities in fiscal years beginning after December 15, 2016, and in the interim periods within those fiscal years. The guidance requires a mix of prospective, modified retrospective and retrospective transition. The Company adopted the provisions of ASU 2016-09 as of January 1, 2017. The impact from adoption of the provisions related to forfeiture rates was reflected in the Company's condensed consolidated financial statements on a modified retrospective basis, resulting in an adjustment of $0.01 million to retained earnings. Provisions related to windfall tax benefits have been adopted prospectively resulting in an adjustment of $1.2 million to retained earnings. Provisions related to the statement of cash flows remain unchanged from prior periods.

Recent Accounting Pronouncements Yet to be Adopted

In November 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-18, Statement of Cash Flows: Restricted Cash, providing guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. ASU 2016-18 is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. The amendments in this ASU would be applied using a retrospective approach. The Company is evaluating the impact of the accounting standard on the financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The ASU update addresses eight specific cash flow issues that currently result in diverse practices, including debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination and separately identifiable cash flows and applicability of the predominance principle. ASU 2016-15 is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. The Company is evaluating the impact of the accounting standard on the financial statements.

The FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The guidance is intended to improve the recognition and measurement of financial instruments. The ASU affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. The guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is evaluating the impact of the accounting standard on its financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Public business entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company continues to evaluate the impact of the accounting standard on its financial statements. In order to determine the effect of the new standard, during 2016 the Company attended live and web-based training sessions hosted by experts on the new standard, identified key areas in our business that could be affected by the standard and hosted internal training sessions on the new standard for accounting staff. The Company has also begun to evaluate its internal controls framework to identify any new controls that may be necessary to comply with the new standard. Although this determination is subject to change as the Company continues to evaluate the new standard, based on our review to date, the Company does not believe that the new standard will have a material effect on its financial statements. The Company plans to adopt the new standards after December 15, 2017.

In May 2017, the FASB issued ASU No. 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which clarifies when modification accounting should be applied for changes to terms or conditions of a share-based payment award. This ASU will be applied prospectively and is effective for fiscal years

Table of Contents

beginning after December 15, 2017, and interim periods within those years, with early adoption permitted. The Company does not expect this standard to have a material impact on its financial statements.

On February 25, 2016, the FASB released ASU No. 2016-02, Leases, to complete its project to overhaul lease accounting. The ASU codifies ASC 842, Leases, which will replace the guidance in ASC 840. The guidance will require lessees to recognize most leases on the balance sheet for capital and operating leases. The guidance is effective for public business entities in fiscal years beginning after December 15, 2018. The Company is evaluating the impact of the accounting standard on its financial statements by reviewing the standard itself, as well as reviewing literature about the new standard produced by nationally-recognized accounting firms and other third parties.

Note 3. Fair Value of Financial Instruments

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

	As of June 30, 2017				As of December 31, 2016			
	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)	Total
Assets:								
Cash and cash equivalents	$ 74,825	$ —	$ —	$ 74,825	$ 50,224	$ —	$ —	$ 50,224
Restricted cash	1,054	—	—	1,054	1,740	—	—	1,740
Short term investments	42	—	—	42	44	—	—	44
Total assets	$ 75,921	$ —	$ —	$ 75,921	$ 52,008	$ —	$ —	$ 52,008
Liabilities:								
Bank acceptance payable	—	$ —	—	$ —	—	$ 307	—	$ 307
Total liabilities	$ —	$ —	$ —	$ —	$ —	$ 307	$ —	$ 307

The carrying value amounts of accounts receivable, prepaid expenses and other current assets, accounts payable, accrued expenses and other current liabilities approximate fair value because of the short-term maturity of these instruments. The carrying value of the term loans approximate fair value due to the variable interest rates.

Note 4. Earnings Per Share

Basic net income (loss) per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from stock options and restricted stock units outstanding during the period.

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

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net income (loss)	$ 29,071	$ 603	$ 48,860	$ (727)
Denominator:				
Weighted average shares used to compute net income (loss) per share				
Basic	19,081	17,091	18,841	17,011
Effective of dilutive options and restricted stock units	1,286	364	1,115	—
Diluted	20,367	17,455	19,956	17,011
Net income (loss) per share				
Basic	$ 1.52	$ 0.04	$ 2.59	$ (0.04)
Diluted	$ 1.43	$ 0.03	$ 2.45	$ (0.04)

Table of Contents

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

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Employee stock options	—	—	—	898
Restricted stock units	—	—	—	62
	—	—	—	960

Note 5. Inventories

Inventories, net of inventory writedowns, consist of the following for the periods indicated (in thousands):

	June 30, 2017	December 31, 2016
Raw materials	$ 25,824	$ 21,518
Work in process and sub-assemblies	27,607	24,334
Finished goods	6,270	5,965
	$ 59,701	$ 51,817

The lower of cost or market adjustment expensed for inventory for the three months ended June 30, 2017 and 2016 was $0.2 million and $1.5 million, respectively. The lower of cost or market adjustment expensed for inventory for the six months ended June 30, 2017 and 2016 was $0.7 million and $1.8 million, respectively.

Note 6. Property, Plant & Equipment

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

	June 30, 2017	December 31, 2016

Land improvements	$ 797	$ 792
Building and improvements	71,253	69,368
Machinery and equipment	130,851	108,724
Furniture and fixtures	4,510	4,227
Computer equipment and software	7,502	6,836
Transportation equipment	645	236
	215,558	190,183
Less accumulated depreciation and amortization	(58,596)	(49,175)
	156,962	141,008
Construction in progress	7,091	1,989
Land	1,101	1,101
Property, plant and equipment, net	$ 165,154	$ 144,098

For the three months ended June 30, 2017 and 2016, depreciation expense of property, plant and equipment was $4.5 million and $3.2 million, respectively. For the six months ended June 30, 2017 and 2016, depreciation expense of property, plant and equipment was $8.7 million and $6.0 million, respectively.

Included in depreciation expense was $2.8 million and $2.1 million recorded as cost of sales for the three months ended June 30, 2017 and 2016, respectively. Included in depreciation expense was $5.4 million and $4.0 million recorded as cost of sales for the six months ended June 30, 2017 and 2016, respectively.

Table of Contents

Note 7. Intangible Assets, net

Intangible assets consisted of the following for the periods indicated (in thousands):

	June 30, 2017		
	Gross Amount	Accumulated amortization	Intangible assets, net
Patents	$ 6,266	$ (2,262)	$ 4,004
Trademarks	14	(11)	3
Total intangible assets	$ 6,280	$ (2,273)	$ 4,007

	December 31, 2016		
	Gross Amount	Accumulated amortization	Intangible assets, net
Patents	$ 5,987	$ (1,997)	$ 3,990
Trademarks	14	(11)	3
Total intangible assets	$ 6,001	$ (2,008)	$ 3,993

For the three months ended June 30, 2017 and 2016, amortization expense for intangible assets, included in general and administrative expenses on the income statement, was each $0.1 million. For the six months ended June 30, 2017 and 2016, amortization expense for intangible assets, included in general and administrative expenses on the income statement, was $0.3 million, respectively.

The remaining weighted average amortization period for intangible assets is approximately 8 years.

Note 8. Notes Payable and Long-Term Debt

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

	June 30, 2017	December 31, 2016
Revolving line of credit with a U.S. bank up to $40,000 with interest at LIBOR plus 2%, maturing June 30, 2018	$ —	$ —
Term loan with a U.S. bank with monthly payments of principal and interest at LIBOR plus 2%, maturing July 31, 2019	—	2,925
Term loan with a U.S. bank with monthly payments of principal and interest at LIBOR plus 2%, maturing June 30, 2020	—	9,500
Term loan with a U.S. bank with monthly payments of principal and interest at LIBOR plus 2%, maturing January 26, 2022	21,370	21,670
Notes payable to a finance company due in monthly installments with 4.5% interest, maturing May 27, 2018 and June 30, 2018	1,205	2,919
Notes payable to a finance company due in monthly installments with 4% interest, maturing March 31, 2019	4,791	5,812
Total	27,366	42,826
Less current portion	(4,552)	(7,865)
Non-current portion	$ 22,814	$ 34,961
Bank Acceptance Notes Payable		
Bank acceptance notes issued to vendors with a zero percent interest rate	$ —	$ 307

The current portion of long-term debt is the amount payable within one year of the balance sheet date of June 30, 2017. The one-month London Interbank Offered Rate (LIBOR) was 1.22389% on June 30, 2017.

Table of Contents

Maturities of long-term debt are as follows for the future one-year periods ending June 30, (in thousands):

2018	$ 4,552
2019	2,673
2020	641
2021	662
2022	18,838
2023 and thereafter	—
Total outstanding	$ 27,366

On June 24, 2016, the Company entered into a First Amendment to the Credit Agreement with East West Bank and Comerica Bank ("First Amendment"), a second lien deed of trust, multiple security agreements and promissory notes evidencing two credit facilities and a term loan originally entered into on June 30, 2015. The First Amendment increased the Company's revolving lines of credit from $25 million to $40 million, which mature on June 30, 2018, and retained a $10.0 million term loan maturing on June 30, 2020. The First Amendment also provides for an additional $10.0 million equipment term loan with a one year drawdown period commencing on April 1, 2016 and maturing five years from the closing date of the First Amendment. The interest rate on these loans was adjusted by the First Amendment from the LIBOR Borrowing Rate plus 2.75% or 3.0% to LIBOR Borrowing Rate plus 2.0%. As of June 30, 2017, no balance was outstanding under the revolving line of credit. On February 27, 2017, the Company repaid the outstanding balance of $9.4 million under the term loan and terminated the loan.

The Company also had a term loan with East West Bank of $5.0 million with monthly payments of principal and interest that matured on July 31, 2019. On February 27, 2017, the Company repaid the outstanding balance of $2.8 million and terminated the loan.

On June 24, 2016, the Company executed a Change in Terms Agreement, Notice of Final Agreement and Modification of the Construction Loan Agreement (the "Modification Agreement") in connection with the Construction Loan Agreement with East West Bank for up to $22.0 million dollars to finance the construction of the Company's campus expansion plan in Sugar Land, Texas, originally dated January 26, 2015 (the "Construction Loan Agreement"). Upon signing the original Construction Loan Agreement, the Company deposited $11.0 million into a restricted bank account for owner's contribution of construction costs. The Modification Agreement has a fifteen-month draw down period with monthly interest payments commencing on February 26, 2015 and ending on July 31, 2016. Thereafter, the entire outstanding principal balance shall be converted to a sixty-six month term loan with principal and interest payments due monthly amortized over three hundred months. The first principal and interest payment commenced on August 26, 2016, and continue the same day of each month thereafter. The final principal and interest payment is due on January 26, 2022 and will include all unpaid principal and all accrued and unpaid interest. The Company may pay without penalty all or a portion of the amount owed earlier than due. Under the Construction Loan Agreement, the loan bears interest at an annual rate based on the one-month LIBOR Borrowing Rate plus 2.75%, and the interest rate is adjusted to LIBOR Borrowing Rate plus 2.0% under the Modification Agreement.

On September 27, 2016, the Company executed a Change in Terms Agreement, Notice of Final Agreement and Second Modification to the Construction Loan Agreement (the "Second Modifications") to the Construction Loan Agreement with East West Bank. The Second Modifications amends and restates in part the Company's Promissory Note and Construction Loan Agreement, which was originally executed on January 26, 2015, and the Modification Agreement. The draw down period end date, under the Second Modifications, was amended from July 31, 2016 to September 30, 2016. And thereafter, the entire outstanding principal balance shall be converted to a sixty-four (64) month term loan, amended from a sixty (66) month term loan, with principal and interest payments due monthly amortized over three hundred (300) months. The first principal and interest payment was due on October 26, 2016 and will continue on the same day of each month thereafter. The final principal and interest payment is due on January 26, 2022 and will include all unpaid principal and all accrued and unpaid interest. Except as expressly changed by the Second Modifications, the terms of the original obligation and the Modification Agreement remain unchanged. As of June 30, 2017, $21.4 million was outstanding under the construction loan.

The loan and security agreements with East West Bank and Comerica Bank require the Company to maintain certain financial covenants, including a minimum cash balance, a current ratio, a maximum leverage ratio and a minimum fixed charge coverage ratio. Collateral for the U.S. bank loans and line of credit includes substantially all of

Table of Contents

the assets of the Company. As of June 30, 2017, the Company was in compliance with all covenants contained in these agreements.

On May 27, 2015, the Company's Taiwan branch entered into a Purchase and Sale Contract and a Finance Lease Agreement with Chailease Finance Co, Ltd. ("Chailease") in connection with certain equipment, structured as a sale lease-back transaction. Pursuant to the sale contract, the Company's Taiwan branch sold certain equipment to Chailease for a purchase price of 180,148,532 New Taiwan dollars, approximately $6 million, and simultaneously leased the equipment back from Chailease pursuant to the Finance Lease Agreement. The monthly lease payments range from 3,784,000 New Taiwan dollars, approximately $0.1 million, to 3,322,413 New Taiwan dollars, approximately $0.1 million, during the term of the Finance Lease Agreement, including an initial payment in an amount of 60,148,532 New Taiwan dollars, approximately $2 million. The Finance Lease Agreement has a three-year term, with monthly payments, maturing on May 27, 2018. The title to the equipment will be transferred to the Company's Taiwan branch upon the expiration of the Finance Lease Agreement. As of June 30, 2017, $1.2 million was outstanding under this Finance Lease Agreement.

On March 31, 2016, the Company's Taiwan branch entered into a Purchase and Sale Contract and a Finance Lease Agreement with Chailease in connection with certain equipment, structured as a sale lease-back transaction. Pursuant to the Purchase and Sale Contract, the Company's Taiwan branch sold certain equipment to Chailease for a purchase price of 312,927,180 New Taiwan dollars, approximately $10.1 million, and simultaneously leased the equipment back from Chailease pursuant to the Finance Lease Agreement. The Finance Lease Agreement has a three-year term with monthly lease payments range from 6,772,500 New Taiwan dollars, approximately $0.2 million, to 7,788,333 New Taiwan dollars, approximately $0.3 million, during the term of the Finance Lease Agreement, including an initial payment in an amount of 62,927,180 New Taiwan dollars, approximately $2.0 million. Based on the payments made under the Finance Lease Agreement, the annual interest rate is calculated to be 4.0%. The title to the equipment will be transferred to the Company's Taiwan branch upon the expiration of the Finance Lease Agreement. As of June 30, 2017, $4.8 million was outstanding under this Finance Lease Agreement.

The Company's Chinese subsidiary had credit facilities with China Construction Bank totaling $13.2 million, which could be drawn in U.S. currency, RMB currency, issuing bank acceptance notes to vendors with different interest rates or issuing standby letters of credit. The Company pledged the land use rights and buildings of its Chinese subsidiary as collateral for the credit facility. The Company's Chinese subsidiary used $10.0 million of its credit facility to issue standby letters of credit as collateral for the Company's Taiwan branch line of credit with China Construction Bank. As of June 30, 2017, the Company had repaid all outstanding balances and terminated the loan agreement with China Construction Bank.

As of June 30, 2017 and December 31, 2016, the Company had $50.0 million and $75.8 million of unused borrowing capacity, respectively.

As of June 30, 2017, there was no restricted cash, investments or security deposit associated with the loan facilities. As of December 31, 2016, there was $1.7 million of restricted cash, investments or security deposit associated with the loan facilities.

Table of Contents

Note 9. Accrued Liabilities

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

	June 30, 2017	December 31, 2016
Accrued payroll	$ 7,249	$ 9,231
Accrued rent	1,081	959
Accrued employee benefits	1,292	1,572
Accrued state and local taxes	495	607
Advance payments	490	252
Accrued product warranty	853	705
Accrued commission expenses	322	205
Accrued professional fees	663	163
Accrued capital expenditures	250	—
Accrued other	1,155	758
	$ 13,850	$ 14,452

Note 10. Other Income and Expense

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

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Foreign exchange transaction loss	(128)	(877)	(700)	(545)
Government subsidy income	75	20	75	20
Other non-operating gain	108	6	121	12
Gain (loss) on disposal of assets	9	(81)	(40)	(85)
	$ 64	$ (932)	$ (544)	$ (598)

Note 11. Share-Based Compensation

Equity Plans

The Company's board of directors and stockholders approved the following equity plans:

- the 1998 Share Incentive Plan
- the 2000 Share Incentive Plan
- the 2004 Share Incentive Plan
- the 2006 Share Incentive Plan
- the 2013 Equity Incentive Plan ("2013 Plan")

The Company issued stock options, restricted stock awards ("RSAs") and restricted units ("RSUs") to employees, consultants and non-employee directors. Stock option awards generally vest over a four year period and have a maximum term of ten years. Stock options under these plans have been granted with an exercise price equal to the fair market value on the date of the grant. Nonqualified and Incentive Stock Options, RSAs and RSUs may be granted from these plans. Prior to the Company's initial public offering in September 2013, the fair market value of the Company's stock had been historically determined by the board of directors and from time to time with the assistance of third party valuation specialists.

Stock Options

Options have been granted to the Company's employees under the five incentive plans and generally become exercisable as to 25% of the shares on the first anniversary date following the date of grant and 12.5% on a semi-annual basis thereafter. All options expire ten years after the date of grant.

Table of Contents

The following is a summary of option activity (in thousands, except per share data):

	Number of shares	Weighted Average Exercise Price	Weighted Average Share Price on Date of Exercise	Weighted Average Fair Value	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding, January 1, 2017	1,130	$ 9.40		$ 4.90		$ 15,872
Exercised	(262)	7.77	$ 51.56	4.14		11,475
Forfeited	(41)	7.61		4.49		2,230
Outstanding, June 30, 2017	827	$ 10.00		$ 5.16	6.16	$ 42,826
Exercisable, June 30, 2017	713	$ 9.88			6.13	$ 37,021
Vested and expected to vest	827	$ 10.00			6.16	$ 42,826

As of June 30, 2017, there was approximately $0.3 million of unrecognized stock option expense, which is expected to be recognized over 0.3 years.

Restricted Stock Units/Awards

RSUs or RSAs have been granted to the Company’s employees under the 2013 Plan and generally vest over a period of four years with 25% of the shares vesting over each of the one-year periods.

The following is a summary of RSU/RSA activity (in thousands, except per share data):

	Number of shares	Weighted Average Share Price on Date of Release	Weighted Average Fair Value	Aggregate Intrinsic Value
Outstanding at January 1, 2017	517		$ 14.79	$ 12,128
Granted	500		38.08	19,043
Released	(103)	$ 48.55	13.40	4,987
Cancelled/Forfeited	(25)		20.36	1,537
Outstanding, June 30, 2017	889		$ 27.88	$ 54,986
Exercisable, June 30, 2017	—			$ —

Vested and expected to vest	889	$ 54,986

As of June 30, 2017, there was $21.8 million of unrecognized compensation expense related to these RSUs and RSAs. This expense is expected to be recognized over 3.3 years.

Share-Based Compensation

Employee share-based compensation expenses recognized for the periods indicated (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Share-Based compensation - by expense type				
Cost of goods sold	$ 134	$ 50	$ 212	$ 87
Research and development	441	154	706	272
Sales and marketing	169	94	249	167
General and administrative	1,516	677	2,600	1,257
Total share-based compensation expense	$ 2,260	$ 975	$ 3,767	$ 1,783

Table of Contents

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Share-Based compensation - by award type				
Employee stock options	$ 268	$ 359	$ 547	$ 737
Restricted stock units	1,992	616	3,220	1,046
Total share-based compensation expense	$ 2,260	$ 975	$ 3,767	$ 1,783

Note 12. Stockholders’ Equity

Common Stock

The Company’s Amended and Restated Certificate of Incorporation authorizes the issuance of up to 45,000,000 shares of common stock, all of which have been designated voting common stock.

Preferred Stock

The Company’s Amended and Restated Certificate of Incorporation authorizes the issuance of up to 5,000,000 shares of preferred stock.

Public Offerings of Common Stock

On October 17, 2016, the Company filed a Registration Statement on Form S-3 with the Securities and Exchange Commission effective November 1, 2016, providing for the public offer and sale of certain securities of the Company from time to time, at its discretion, up to an aggregate amount of $250 million. In connection with such Form S-3, the Company entered into an Equity Distribution Agreement with Raymond James & Associates, Inc. pursuant to which the Company may issue and sell shares of the Company’s stock having an aggregate offering price of up to $50.0 million (the “ATM Offering”) from time to time through Raymond James & Associates, Inc. On November 22, 2016, the Company commenced sales of common stock through the ATM Offering. The Company completed its ATM Offering in March 2017 and sold 1.6 million shares of common stock at a weighted average price of $31.55 per share, providing proceeds of $48.8 million, net of expenses and underwriting discounts and commissions.

Note 13. Geographic Information

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

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

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Revenues:				
United States	$ 4,112	$ 18,018	$ 8,631	$ 41,257
Taiwan	67,696	28,470	119,321	52,288
China	45,563	8,766	85,643	12,131
	$ 117,371	$ 55,254	$ 213,595	$ 105,676

Table of Contents

	As of the period ended	
	June 30, 2017	December 31, 2016
Long-lived assets:		
United States	$ 68,515	$ 66,028
Taiwan	57,335	48,728
China	44,097	34,113
	$ 169,947	$ 148,869

Note 14. Contingencies

Litigation

Overview

From time to time, the Company may be subject to legal proceedings and litigation arising in the ordinary course of business, including, but not limited to, inquiries, investigations, audits and other regulatory proceedings, such as described below. The Company records a loss provision when it believes it is both probable that a liability has been incurred and the amount can be reasonably estimated. Unless otherwise disclosed, the Company is unable to estimate the possible loss or range of loss for the legal proceeding described below.

Except for the lawsuit described below, the Company believes that there are no claims or actions pending or threatened against it, the ultimate disposition of which would have a material adverse effect on it.

Class Action and Shareholder Derivative Litigation

On August 5, 2017, a lawsuit was filed in the U.S. District Court for the Southern District of Texas against the Company and two of its officers in Mona Abouzied v. Applied Optoelectronics, Inc., Chih-Hsiang (Thompson) Lin, and Stefan J. Murry, et al., Case No. 4:17-cv-02399. The complaint in this matter seeks class action status on behalf of the Company's shareholders, alleging violations of Sections 10(b) and 20(a) of the Exchange Act against the Company, its chief executive officer, and its chief financial officer, arising out of its announcement on August 3, 2017 that "we see softer than expected demand for our 40G solutions with one of our large customers that will offset the sequential growth and increased demand we expect in 100G." The complaint requests unspecified damages and other relief. The Company disputes the allegations and intends to vigorously contest the matter.

Note 15. Subsequent Events

The Company has evaluated subsequent events through the date the financial statements were available to be issued.

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

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the accompanying notes appearing elsewhere in this Quarterly Report on Form 10-Q for the period ended June 30, 2017 and the audited consolidated financial statements and notes thereto and management’s discussion and analysis of financial condition and results of operations for the fiscal year ended December 31, 2016 included in our Annual Report on Form 10-K. References to “Applied Optoelectronics” “we,” “our” and “us” are to Applied Optoelectronics, Inc. and its subsidiaries unless otherwise specified or the context otherwise requires.

This Quarterly Report on Form 10-Q contains “forward-looking statements” that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Terminology such as "believe," "may," "estimate," "continue," "anticipate," "intend," "should," "could," "would," "target," "seek," "aim," "believe," "predicts," "think," "objectives," "optimistic," "new," "goal," "strategy," "potential," "is likely," "will," "expect," "plan" "project," "permit" or by other similar expressions that convey uncertainty of future events or outcomes 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 industry and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in “Part II —Item 1A. Risk Factors” provided below, and those discussed in other documents we file with the SEC. Furthermore, such forward-looking statements speak only as of the date of this Quarterly Report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of this Quarterly Report.

Overview

We are a leading, vertically integrated provider of fiber-optic networking products, primarily for four networking end-markets: internet data center, cable television, or CATV, fiber-to-the-home, or FTTH, and telecommunication, or telecom. We design and manufacture a range of optical communications products at varying levels of integration, from components, subassemblies and modules to complete turn-key equipment.

In designing products for our customers, we begin with the fundamental building blocks of lasers and laser components. From these foundational products, we design and manufacture a wide range of products to meet our customers' needs and specifications, and such products differ from each other by their end market, intended use and level of integration. We are primarily focused on the higher-performance segments within all four of our target markets, which increasingly demand faster connectivity and innovation.

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

Our vertically integrated manufacturing model provides us several advantages, including rapid product development, fast response times to customer requests and control over product quality and manufacturing costs. We design, manufacture and integrate our own analog and digital lasers using a proprietary Molecular Beam Epitaxy, or MBE, and Metal Organic Chemical Vapor Deposition (MOCVD) fabrication process, which we believe is unique in our industry. We manufacture the majority of the laser chips and optical components that are used in our products. The lasers

Table of Contents

we manufacture are proven to be reliable over time and highly tolerant of changes in temperature and humidity, making them well-suited to the CATV and FTTH markets where networking equipment is often installed outdoors.

We have three manufacturing sites: Sugar Land, Texas, Ningbo, China and Taipei, Taiwan. We have an additional research and development center in Lawrenceville, Georgia. In our Sugar Land facility, we manufacture laser chips (utilizing our MBE process), subassemblies and components. The subassemblies are used in the manufacture of components by our other manufacturing facilities or sold to third parties as modules. We manufacture our laser chips only within our Sugar Land facility, where our laser design team is located. In our Taiwan location, we manufacture optical components, such as our butterfly lasers, which incorporate laser chips, subassemblies and components manufactured within our U.S. facility. In addition, in our Taiwan location, we manufacture transceivers for the internet data center, FTTH, telecom, and other markets. In our China facility, we take advantage of lower labor costs and manufacture certain more labor intensive components and optical equipment systems, such as optical subassemblies for the internet data center market, CATV transmitters (at the headend) and CATV outdoor equipment (at the node). Each manufacturing facility conducts testing on the components, modules or subsystems it manufactures and each such facility is certified to ISO 9001:2008. Our facilities in Ningbo, China, Taipei, Taiwan, and Sugar Land, TX are all certified to ISO 14001:2004.

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

Our principal executive offices are located at 13139 Jess Pirtle Blvd., Sugar Land, TX 77478, and our telephone number is (281) 295-1800.

Table of Contents

Results of Operations

The following table set forth our consolidated results of operations for the periods presented and as a percentage of our revenue for those periods (in thousands):

	Three months ended June 30, 2017		Three months ended June 30, 2016		Six months ended June 30, 2017		Six months ended June 30, 2016	
Revenue, net	$ 117,371	100.0 %	$ 55,254	100.0 %	$ 213,595	100.0 %	$ 105,676	100.0 %
Cost of goods sold	64,089	54.6 %	37,952	68.7 %	118,841	55.6 %	74,121	70.1 %
Gross profit	53,282	45.4 %	17,302	31.3 %	94,754	44.4 %	31,555	29.9 %
Operating expenses								
Research and development	8,073	6.9 %	7,814	14.1 %	15,505	7.3 %	16,210	15.3 %
Sales and marketing	2,158	1.8 %	1,610	2.9 %	4,061	1.9 %	3,290	3.1 %
General and administrative	8,786	7.5 %	5,906	10.7 %	16,608	7.8 %	11,639	11.0 %
Total operating expenses	19,017	16.2 %	15,330	27.7 %	36,174	16.9 %	31,139	29.5 %
Income (loss) from operations	34,265	29.2 %	1,972	3.6 %	58,580	27.4 %	416	0.4 %
Other income (expense)								
Interest income	70	0.1 %	65	0.1 %	105	0.0 %	166	0.2 %
Interest expense	(245)	(0.2) %	(450)	(0.8) %	(544)	(0.3) %	(851)	(0.8) %
Other income (expense), net	64	0.1 %	(932)	(1.7) %	(544)	(0.3) %	(598)	(0.6) %
Total other income (expense)	(111)	(0.1) %	(1,317)	(2.4) %	(983)	(0.5) %	(1,283)	(1.2) %
Income (loss) before income taxes	34,154	29.1 %	655	1.2 %	57,597	27.0 %	(867)	(0.8) %
Income tax (expense) benefit	(5,083)	(4.3) %	(52)	(0.1) %	(8,737)	(4.1) %	140	0.1 %
	$ 29,071	24.8 %	$ 603	1.1 %	$ 48,860	22.9 %	$ (727)	(0.7) %

Net income
(loss)

Comparison of Financial Results

Revenue

We generate revenue through the sale of our products to equipment providers and network operators for the internet data center, CATV, FTTH and telecom markets. We derive a significant portion of our revenue from our top ten customers, and we anticipate that we will continue to do so for the foreseeable future. The following charts provide the revenue contribution from each of the markets we served for the three and six months ended June 30, 2017 and 2016 (in thousands):

	Three months ended June 30,				Six months ended June 30,			
	2017		2016		2017		2016	
CATV	12.3	%	17.2	%	12.9	%	16.3	%
Data Center	84.6	%	74.7	%	83.8	%	75.9	%
FTTH	0.1	%	0.8	%	0.1	%	0.8	%
Telecom	2.6	%	6.4	%	2.9	%	6.3	%
Other	0.4	%	0.8	%	0.3	%	0.6	%
	100.0	%	100.0	%	100.0	%	100.0	%

Table of Contents

	Three months ended June 30,		Change		Six months ended June 30,		Change	
	2017	2016	Amount	%	2017	2016	Amount	%
CATV	$ 14,404	$ 9,521	$ 4,883	51.3 %	$ 27,498	$ 17,252	$ 10,246	59.4 %
Data Center	99,298	41,280	58,018	140.5 %	178,892	80,260	98,632	122.9 %
FTTH	125	436	(311)	(71.3) %	223	857	(634)	(74.0) %
Telecom	3,077	3,563	(486)	(13.6) %	6,248	6,641	(393)	(5.9) %
Other	467	454	13	2.9 %	734	666	68	10.2 %
Total Revenue	$ 117,371	$ 55,254	$ 62,117	112.4 %	$ 213,595	$ 105,676	$ 107,919	102.1 %

Growth in the three and six months ended June 30, 2017 was driven primarily by increasing revenue from our internet data center customers, and we also anticipate that our revenue derived from this market will continue to increase as a percentage of our revenue as we further penetrate and extend our products into this market.

During the three and six months ended June 30, 2017, revenues in the internet data center market were driven primarily by increasing demand for our 40 gigabits per second, or Gbps, and 100 Gbps transceivers as our customers continued to upgrade their technology infrastructure. The decrease in revenue in our FTTH market is due to a decline in demand for certain older legacy products. Demand for these legacy products is expected to continue to fluctuate. The increase in revenues in the CATV market for the three and six month ended June 30, 2017 was a result of increased demand from customers who are supplying equipment for CATV network upgrades which began during the year. Revenue in our telecom market decreased modestly for the the three and six month periods ended June 30, 2017, compared to the prior year. The decrease is primarily attributable to reduced orders for some of our telecom customers, particularly in China. Revenue in the telecom and other markets remained relatively unchanged during the three and six months ended June 30, 2017.

For the three months ended June 30, 2017 and 2016, our top ten customers represented 95.4% and 91.6%, respectively. For the six months ended June 30, 2017 and 2016, our top ten customers represented 96.2% and 91.5%, respectively.

Cost of goods sold and gross margin

	Three months ended June 30,					
	2017		2016		Change	
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(in thousands, except percentages)					
Cost of goods sold	$ 64,089	54.6 %	$ 37,952	68.7 %	$ 26,137	68.9 %

Gross margin	53,282	45.4	%	17,302	31.3	%

	Six months ended June 30,									
	2017			2016			Change			
	Amount	% of Revenue		Amount	% of Revenue		Amount	%		
	(in thousands, except percentages)									
Cost of goods sold	$ 118,841	55.6	%	$ 74,121	70.1	%	$ 44,720	60.3	%	
Gross margin	94,754	44.4	%	31,555	29.9	%				

Cost of goods sold increased by $26.1 million, or 68.9%, for the three months ended June 30, 2017, as compared to the three months ended June 30, 2016, primarily due to the increase in sales over the prior year. Cost of goods sold increased by $44.7 million, or 60.3%, for the six months ended June 30, 2017, as compared to the six months ended June 30, 2016, primarily due to the increase in sales over the prior year. The increase in gross margin for the three and six months ended June 30, 2017 compared to the same periods ended June 30, 2016 was primarily the result of lower production costs associated with certain 40 Gbps and 100 Gbps products. Production costs were reduced due mainly to improved product yields, related to process improvements and automation, as well as raw material cost reduction.

Table of Contents

Operating expenses

	Three months ended June 30,									
	2017			2016			Change			
	Amount	% of revenue		Amount	% of revenue		Amount	%		
	(in thousands, except percentages)									
Research and development	$ 8,073	6.9	%	$ 7,814	14.1	%	$ 259	3.3	%	
Sales and marketing	2,158	1.8	%	1,610	2.9	%	548	34.0	%	
General and administrative	8,786	7.5	%	5,906	10.7	%	2,880	48.8	%	
Total operating expenses	$ 19,017	16.2	%	$ 15,330	27.7	%	$ 3,687	24.1	%	

Six months ended June 30,		
2017	2016	Change