AEHR TEST SYSTEMS
Form 10-Q
January 14, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 30, 2018

OR

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

For the transition period from _________ to __________

Commission file number: 000-22893

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

California	94-2424084
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

400 Kato Terrace Fremont, CA	94539
(Address of principal executive offices)	(Zip Code)

(510) 623-9400
Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 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	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

Number of shares of the registrant's common stock, $0.01 par value, outstanding as of December 31, 2018 was 22,355,831.

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AEHR TEST SYSTEMS
FORM 10-Q
FOR THE QUARTER ENDED NOVEMBER 30, 2018

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS (Unaudited)

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

	November 30,	May 31,
	2018	2018
		(1)
ASSETS		
Current assets:		
Cash and cash equivalents	$14,002	$16,848
Accounts receivable, net	3,868	2,856
Inventories	9,983	9,049
Prepaid expenses and other current assets	688	703
Total current assets	28,541	29,456
Property and equipment, net	1,074	1,203
Other assets	286	296
Total assets	$29,901	$30,955
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,953	$1,762
Accrued expenses	1,487	1,646
Customer deposits and deferred revenue, short-term	2,068	1,630
Current portion of long-term debt	6,110	6,110
Total current liabilities	11,618	11,148
Deferred rent	147	63
Deferred revenue, long-term	252	459

Total liabilities	12,017	11,670
Aehr Test Systems shareholders' equity:		
Common stock, $0.01 par value: Authorized: 75,000 shares; Issued and outstanding: 22,356 shares and 22,143 shares at November 30, 2018 and May 31, 2018, respectively	224	221
Additional paid-in capital	83,830	83,041
Accumulated other comprehensive income	2,241	2,292
Accumulated deficit	(68,393)	(66,249)
Total Aehr Test Systems shareholders' equity	17,902	19,305
Noncontrolling interest	(18)	(20)
Total shareholders' equity	17,884	19,285
Total liabilities and shareholders' equity	$29,901	$30,955

(1)
The condensed consolidated balance sheet at May 31, 2018 has been derived from the audited consolidated financial statements at that date.

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

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

	Three Months Ended		Six Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Net sales	$5,911	$7,923	$10,651	$14,893
Cost of sales	3,513	4,792	6,700	8,844
Gross profit	2,398	3,131	3,951	6,049
Operating expenses:				
Selling, general and administrative	1,977	1,854	3,856	3,645
Research and development	986	1,090	2,102	2,045
Total operating expenses	2,963	2,944	5,958	5,690
(Loss) income from operations	(565)	187	(2,007)	359
Interest expense, net	(74)	(105)	(152)	(212)
Other income (expense), net	29	(7)	38	(67)
(Loss) income before income tax expense	(610)	75	(2,121)	80
Income tax expense	(19)	(15)	(23)	(10)
Net (loss) income	(629)	60	(2,144)	70
Less: Net income attributable to the noncontrolling interest	--	--	--	--
Net (loss) income attributable to Aehr Test Systems common shareholders	$(629)	$60	$(2,144)	$70
Net (loss) income per share				
Basic	$(0.03)	$0.00	$(0.10)	$0.00
Diluted	$(0.03)	$0.00	$(0.10)	$0.00
Shares used in per share calculations:				

Basic	22,294	21,645	22,242	21,531
Diluted	22,294	22,883	22,242	22,937

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

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AEHR TEST SYSTEMS
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(in thousands, unaudited)

	Three Months Ended		Six Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Net (loss) income	$(629)	$60	$(2,144)	$70
Other comprehensive (loss) income, net of tax: Net change in unrealized loss on investments	--	(3)	--	(3)
Net change in cumulative translation adjustments	(34)	1	(49)	60
Total comprehensive (loss) income	(663)	58	(2,193)	127
Less: Comprehensive income attributable to the noncontrolling interest	1	--	2	--
Comprehensive (loss) income, attributable to Aehr Test Systems common shareholders	$(664)	$58	$(2,195)	$127

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

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

	Six Months Ended	
	November 30,	
	2018	2017
Cash flows from operating activities:		
Net (loss) income	$(2,144)	$70
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Stock-based compensation expense	480	580
Recovery of doubtful accounts	(3)	(14)
Depreciation and amortization	230	190
Changes in operating assets and liabilities:		
Accounts receivable	(1,068)	592
Inventories	(935)	(1,249)
Prepaid expenses and other current assets	23	(1,135)
Accounts payable	302	(1,005)
Accrued expenses	(175)	5
Customer deposits and deferred revenue	231	(178)
Deferred rent	84	--
Income taxes payable	18	(9)
Net cash used in operating activities	(2,957)	(2,153)
Cash flows from investing activities:		
Purchases of investments	--	(5,972)
Purchases of property and equipment	(103)	(313)
Net cash used in investing activities	(103)	(6,285)
Cash flows from financing activities:		
Proceeds from issuance of common stock under employee plans, net of taxes paid related to share settlement of equity awards	312	601
Net cash provided by financing activities	312	601
Effect of exchange rates on cash and cash equivalents	(98)	(7)
Net decrease in cash and cash equivalents	(2,846)	(7,844)
Cash and cash equivalents, beginning of period	16,848	17,803

Cash and cash equivalents, end of period	$14,002	$9,959
Supplemental disclosure of non-cash flow information:		
Transfers of property and equipment to inventories	$--	$372

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

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

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCCOUNTING POLICIES

The accompanying financial information has been prepared by Aehr Test Systems, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations.

In the opinion of management, the unaudited condensed consolidated financial statements for the interim periods presented have been prepared on a basis consistent with the May 31, 2018 audited consolidated financial statements and reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the condensed consolidated financial position and results of operations as of and for such periods indicated. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2018. Results for the interim periods presented herein are not necessarily indicative of results which may be reported for any other interim period or for the entire fiscal year.

PRINCIPLES OF CONSOLIDATION. The condensed consolidated financial statements include the accounts of Aehr Test Systems and its subsidiaries (collectively, the "Company"). All significant intercompany balances have been eliminated in consolidation. For the Company’s majority owned subsidiary, Aehr Test Systems Japan K.K., the noncontrolling interest of the portion the Company does not own was reflected on the Condensed Consolidated Balance Sheets in Shareholders’ Equity and in the Condensed Consolidated Statements of Operations.

ACCOUNTING ESTIMATES. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used to account for sales and revenue allowances, the allowance for doubtful accounts, inventory valuations, income taxes, stock-based compensation expenses, and product warranties, among others. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances. Actual results could differ materially from those estimates.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES. The Company’s significant accounting policies are disclosed in the Company’s Annual Report on Form 10-K for the year ended May 31, 2018. There have been no significant changes in the Company's significant accounting policies during the three and six months ended November 30, 2018 except for revenue recognition.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Adopted

Revenue Recognition
In May 2014, the FASB issued Accounting Standards Codification (“ASC”) Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), which has been subsequently updated (collectively “ASC 606”). The core principle of the standard is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The new standard

defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price, and allocating the transaction price to each distinct performance obligation. The standard permits the use of either the retrospective or modified retrospective transition methods. It also requires expanded disclosures including the nature, amount, timing, and uncertainty of revenues and cash flows related to contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract.

The Company adopted ASC 606 on June 1, 2018, the first day of fiscal 2019, using the modified retrospective method. The Company applied ASC 606 to all contracts not completed as of the date of adoption in order to determine any adjustment to the opening balance of retained earnings. Under the modified retrospective adoption method, the comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods, ASC 605, "Revenue Recognition", which is also referred to herein as "legacy GAAP."

The adoption of ASC 606 did not have a material impact on the Company's consolidated financial statements as of June 1, 2018. No adjustment was recorded to accumulated deficit as of the adoption date and reported revenue would not have been different under legacy GAAP. Additionally, the Company does not expect the adoption of the revenue standard to have a material impact to the Company's net income on an ongoing basis.

Classification of Certain Cash Receipts and Cash Payments
In August 2016, the FASB issued authoritative guidance related to the classification of certain cash receipts and cash payments on the statement of cash flows. The Company adopted this new standard in fiscal year 2019. The adoption of this guidance did not have a significant impact on the Company’s consolidated financial statements.

Intra-Entity Asset Transfers
In October 2016, the FASB issued an accounting standard update that requires recognition of the income tax consequences of intra-entity transfers of assets (other than inventory) at the transaction date. The Company adopted this new standard in fiscal year 2019. The adoption of this guidance did not have a significant impact on the Company’s consolidated financial statements.

Restricted Cash
In November 2016, the FASB issued authoritative guidance related to statements of cash flows. This guidance clarifies that amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of period total amounts shown on the statement of cash flows. The Company adopted this new standard in fiscal year 2019. The adoption of this guidance did not have a significant impact on the Company’s consolidated financial statements.

Income Taxes
On December 22, 2017, the US government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act makes broad and complex changes to the US tax code including but not limited to (1) reducing the US federal corporate tax rate from 34% to 21%; (2) requiring companies to pay a one-time transition tax on certain repatriated earnings of foreign subsidiaries; (3) generally eliminating US federal income taxes on dividends from foreign subsidiaries; (4) requiring a current inclusion in US federal income of certain earnings of controlled foreign corporations; (5) creating a new limitation on deductible interest expense; (6) changing rules related to the uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017, and (7) repeals the corporate alternative minimum tax regime, or AMT, effective December 31, 2017 and permits existing minimum tax credits to offset the regular tax liability for any tax year. Consequently, the Company has accounted for the reduction of $6.4 million of deferred tax assets with an offsetting adjustment to the valuation allowance for the fiscal year ended 2018, and recorded a benefit of $90,000 for the Company's Federal refundable AMT credit.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118") which provides guidance on accounting for the tax effects of the Tax act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740, Income taxes. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. There are also certain transitional impacts of the Tax Act. As part of the transition to the new territorial tax system, the Tax Act imposes a one-time repatriation tax on deemed repatriation of historical earnings of foreign subsidiaries. The company is not subject to the transition tax. The one-time transition tax is based on post-1986 earnings and profits that were previously deferred from U.S. income tax. The Company has finalized its calculation of the total post-1986 earnings and profits for its foreign corporations. Based on the Company's net operating loss carryovers and valuation allowance, there is no impact to its consolidated financial statements as a result of the completion of the analysis.

Accounting Standards Not Yet Adopted

Financial Instruments
In January 2016, the FASB issued an accounting standard update related to recognition and measurement of financial assets and financial liabilities. This standard changes accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. In addition, it clarifies guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. This standard is effective for us in fiscal year 2020. Early adoption is permitted. The Company is currently evaluating the impact of this new guidance on its consolidated financial statements.

In June 2016, the FASB issued an accounting standard update that requires measurement and recognition of expected credit losses for financial assets held based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2021 on a modified retrospective basis, and early adoption in fiscal 2020 is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

Leases
In February 2016, the FASB issued authoritative guidance related to leases. This guidance requires management to present all leases greater than one year on the balance sheet as a liability to make payments and an asset as the right to use the underlying asset for the lease term. This new standard will be effective for us in fiscal year 2020, with early adoption permitted. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

3. REVENUE

Revenue recognition

The Company recognizes revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services by following a five-step process, (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price, and (5) recognize revenue when or as the Company satisfies a performance obligation, as further described below.

Performance obligations include sales of systems, contactors, spare parts, and services, as well as, installation and training services included in customer contracts.

A contract’s transaction price is allocated to each distinct performance obligation. In determining the transaction price, the Company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the Company expects to be entitled. The Company generally does not grant return privileges, except for defective products during the warranty period.

For contracts that contain multiple performance obligations, the Company allocates the transaction price to the performance obligations on a relative standalone selling price basis. Standalone selling prices are based on multiple factors including, but not limited to historical discounting trends for products and services and pricing practices in different geographies.

Revenue for systems and spares are recognized at a point in time, which is generally upon shipment or delivery. Revenue from services is recognized over time as services are completed or ratably over the contractual period of generally one year or less.

The Company has elected the practical expedient under ASC 606 to not assess whether a contract has a significant financing component as the Company's standard payment terms are less than one year.

Disaggregation of revenue

The following tables show revenues by major product categories. Within each product category, contract terms, conditions and economic factors affecting the nature, amount, timing and uncertainty around revenue recognition and cash flow are substantially similar.

The Company's revenues by product category are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Type of good / service:				
Systems	$3,712	$5,030	$5,518	$8,506
Contactors	943	1,867	2,096	4,544
Services	1,256	1,026	3,037	1,843
	$5,911	$7,923	$10,651	$14,893
Product lines:				
Wafer-level	$4,226	$2,812	$6,195	$6,965
Test During Burn-In	1,685	5,111	4,456	7,928
	$5,911	$7,923	$10,651	$14,893

The following presents information about the Company's operations in different geographic areas. Net sales are based upon ship-to location (in thousands):

	Three Months Ended		Six Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Geographic region:				
United states	$4,509	$1,964	$7,204	$3,254
Asia	1,334	5,909	3,068	11,569
Europe	68	50	379	70
	$5,911	$7,923	$10,651	$14,893

With the exception of the amount of service contracts and extended warranties, the Company's product category revenues are recognized at point in time when control transfers to customers.

	Three Months Ended November 30,		Six Months Ended November 30,	
	2018	2017	2018	2017
Timing of revenue recognition:				
Products and services transferred at a point in time	$5,272	$7,387	$9,390	$13,887
Services transferred over time	639	536	1,261	1,006
	$5,911	$7,923	$10,651	$14,893

Contract balances

A receivable is recognized in the period the Company delivers goods or provides services or when the Company's right to consideration is unconditional. The Company usually does not record contract assets because the Company has an unconditional right to payment upon satisfaction of the performance obligation, and therefore, a receivable is more commonly recorded than a contract asset.

Contract liabilities include payments received in advance of performance under a contract and are satisfied as the associated revenue is recognized. Contract liabilities are reported on the Condensed Consolidated Balance Sheets at the end of each reporting period as a component of deferred revenue. Contract liabilities as of November 30, 2018 and May 31, 2018 were $2,321,000 and $2,089,000, respectively. During the three and six months ended November 30, 2018, the Company recognized $392,000 and $994,000, respectively, of revenues that were included in contract liabilities as of May 31, 2018.

Remaining performance obligations

On November 30, 2018, the Company had $695,000 of remaining performance obligations, which were comprised of deferred service contracts and extended warranty contracts not yet delivered. The Company expects to recognize approximately 35% of its remaining performance obligations as revenue in fiscal 2019, and an additional 65% in fiscal 2020 and thereafter. The foregoing excludes the value of other remaining performance obligations as they have original durations of one year or less, and also excludes information about variable consideration allocated entirely to a wholly unsatisfied performance obligation.

Costs to obtain or fulfill a contract

The Company generally expenses sales commissions when incurred as a component of selling, general and administrative expense as the amortization period is typically less than one year. Additionally, the majority of the Company’s cost of fulfillment as a manufacturer of products is classified as inventory and fixed assets, which are accounted for under the respective guidance for those asset types. Other costs of contract fulfillment are immaterial due to the nature of the Company's products and their respective manufacturing process.

4. EARNINGS PER SHARE

Basic earnings per share is determined using the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined using the weighted average number of common shares and potential common shares (representing the dilutive effect of stock options, RSUs and ESPP shares) outstanding during the period using the treasury stock method.

The following table presents the computation of basic and diluted net (loss) income per share attributable to Aehr Test Systems common shareholders (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Numerator: Net (loss) income	$(629)	$60	$(2,144)	$70

Denominator for basic net (loss) income per share:				
Weighted average shares outstanding	22,294	21,645	22,242	21,531
Shares used in basic net (loss) income per share calculation	22,294	21,645	22,242	21,531
Effect of dilutive securities	--	1,238	--	1,406
Denominator for diluted net (loss) income per share	22,294	22,883	22,242	22,937
Basic net (loss) income per share	$(0.03)	$0.00	$(0.10)	$0.00
Diluted net (loss) income per share	$(0.03)	$0.00	$(0.10)	$0.00

For the purpose of computing diluted earnings per share, the weighted average number of potential common shares does not include stock options with an exercise price greater than the average fair value of the Company's common stock for the period, as the effect would be anti-dilutive. In the three and six months ended November 30, 2018 potential common shares have not been included in the calculation of diluted net loss per share as the effect would be anti-dilutive. As such, the numerator and the denominator used in computing both basic and diluted net loss per share for these periods are the same. Stock options to purchase 3,373,000 shares of common stock, RSUs for 38,000 shares and ESPP rights to purchase 327,000 ESPP shares were outstanding as of November 30, 2018, but were not included in the computation of diluted net loss per share, because the inclusion of such shares would be anti-dilutive. Stock options to purchase 263,000 shares of common stock were outstanding as of November 30, 2017 but were not included in the computation of diluted net income per share, because the inclusion of such shares would be anti-dilutive. The 2,657,000 shares convertible under the convertible notes outstanding at November 30, 2018 and 2017 were not included in the computation of diluted net income (loss) per share, because the inclusion of such shares would be anti-dilutive.

5. CASH, CASH EQUIVALENTS AND INVESTMENTS

The following table summarizes the Company's cash, cash equivalents and investments by security type at November 30, 2018 (in thousands):

	Cost	Gross Unrealized Loss	Estimated Fair Value
Cash	$1,961	$--	$1,961
Cash equivalents:			
Money market funds	6,050	--	6,050
U.S. Treasury securities	5,991	--	5,991
Total Cash equivalents	12,041	--	12,041
Total Cash and Cash equivalents	$14,002	$--	$14,002
Long-term investments:			
Certificate of deposit	$80	$--	$80
Total Cash, Cash equivalents and Investments	$14,082	$--	$14,082

Long-term investments are included in other assets on the accompanying condensed consolidated balance sheet at November 30, 2018.

The following table summarizes the Company's cash, cash equivalents and investments by security type at May 31, 2018 (in thousands):

	Cost	Gross Unrealized Loss	Estimated Fair Value
Cash	$3,132	$--	$3,132
Cash equivalents:			

Money market funds	7,733	--	7,733
U.S. Treasury securities	5,983	--	5,983
Total Cash equivalents	13,716	--	13,716