

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 March 31, 2023

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
(State or other jurisdiction of incorporation or organization)

76-0533927
(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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Trading Name of each exchange on which registered
Common Stock, Par value \$0.001	AAOI	NASDAQ Global Market

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

Indicate by check mark whether the registrant has submitted electronically 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	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

As of May 2, 2023 there were 29,195,682 shares of the registrant's Common Stock outstanding.

Applied Optoelectronics, Inc.
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Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements

Applied Optoelectronics, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands)

	<u>March 31,</u> <u>2023</u>	<u>December 31,</u> <u>2022</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 16,103	\$ 24,685
Restricted cash	10,845	10,902
Accounts receivable - trade, net of allowance of \$39 and \$28, respectively	56,799	61,175
Notes receivable	1,079	339
Inventories	70,186	79,679
Prepaid expenses and other current assets	6,517	6,384
Total current assets	161,529	183,164
Property, plant and equipment, net	207,171	210,184
Land use rights, net	5,278	5,238
Operating right of use asset	5,381	5,566
Financing right of use asset	18	26
Intangible assets, net	3,655	3,699
Other assets, net	519	386
TOTAL ASSETS	\$ 383,551	\$ 408,263
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 38,419	\$ 47,845
Bank acceptance payable	19,196	12,337
Accrued liabilities	13,505	17,222
Deferred revenue	2,763	3,000
Current lease liability - operating	1,035	1,041
Current lease liability - financing	58	63
Current portion of notes payable and long-term debt	50,921	57,074
Current portion of Convertible senior notes	79,710	—
Total current liabilities	205,607	138,582
Non-current lease liability - operating	5,307	5,505
Convertible senior notes	—	79,506
TOTAL LIABILITIES	210,914	223,593
Stockholders' equity:		
Common Stock; 45,000 shares authorized at \$0.001 par value; 29,072 and 28,622 shares issued and outstanding at March 31, 2023 and December 31, 2022, respectively	29	29
Additional paid-in capital	394,147	391,526
Accumulated other comprehensive income	3,823	2,183
Accumulated deficit	(225,362)	(209,068)
TOTAL STOCKHOLDERS' EQUITY	172,637	184,670
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 383,551	\$ 408,263

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

Applied Optoelectronics, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except share and per share data)

	Three months ended March 31,	
	2023	2022
Revenue, net	\$ 53,030	\$ 52,242
Cost of goods sold	43,786	43,217
Gross profit	9,244	9,025
Operating expenses		
Research and development	8,536	9,486
Sales and marketing	2,327	2,558
General and administrative	12,548	11,220
Total operating expenses	23,411	23,264
Loss from operations	(14,167)	(14,239)
Other income (expense)		
Interest income	33	28
Interest expense	(2,137)	(1,401)
Other expense, net	(21)	(450)
Total other income (expense), net	(2,125)	(1,823)
Loss before income taxes	(16,292)	(16,062)
Net loss	\$ (16,292)	\$ (16,062)
Net loss per share		
Basic	\$ (0.56)	\$ (0.58)
Diluted	\$ (0.56)	\$ (0.58)
Weighted average shares used to compute net loss per share:		
Basic	28,871,857	27,463,321
Diluted	28,871,857	27,463,321

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

Applied Optoelectronics, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, in thousands)

	Three months ended March 31,	
	2023	2022
Net loss	\$ (16,292)	\$ (16,062)
Gain (Loss) on foreign currency translation adjustment	1,640	(1,262)
Comprehensive loss	<u>\$ (14,652)</u>	<u>\$ (17,324)</u>

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

Applied Optoelectronics, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Three Months ended March 31, 2023 and 2022
(Unaudited, in thousands)

	Preferred Stock		Common Stock		Additional paid-in capital	Accumulated other comprehensive gain (loss)		Accumulated deficit	Stockholders' equity
	Number of shares	Amount	Number of shares	Amount					
December 31, 2022	—	\$ —	28,622	\$ 29	391,526	\$ 2,183	\$ (209,068)	\$ 184,670	
Issuance of restricted stock, net of shares withheld for employee tax	—	—	292	—	(76)	—	—	(76)	
Share-based compensation	—	—	—	—	2,290	—	—	2,290	
Public offering of common stock, net	—	—	158	—	407	—	—	407	
Foreign currency translation adjustment	—	—	—	—	—	1,640	(2)	1,638	
Net loss	—	—	—	—	—	—	(16,292)	(16,292)	
March 31, 2023	—	\$ —	29,072	\$ 29	394,147	\$ 3,823	\$ (225,362)	\$ 172,637	

	Preferred Stock		Common Stock		Additional paid-in capital	Accumulated other comprehensive gain (loss)		Accumulated deficit	Stockholders' equity
	Number of shares	Amount	Number of shares	Amount					
December 31, 2021	—	\$ —	27,323	\$ 27	381,143	\$ 16,071	\$ (142,671)	\$ 254,570	
Issuance of restricted stock, net of shares withheld for employee tax	—	—	207	—	(141)	—	—	(141)	
Share-based compensation	—	—	—	—	2,472	—	—	2,472	
Foreign currency translation adjustment	—	—	—	—	—	(1,262)	—	(1,262)	
Net loss	—	—	—	—	—	—	(16,062)	(16,062)	
March 31, 2022	—	\$ —	27,530	\$ 27	383,474	\$ 14,809	\$ (158,733)	\$ 239,577	

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)

	Three months ended March 31,	
	2023	2022
Operating activities:		
Net loss	\$ (16,292)	\$ (16,062)
Adjustments to reconcile net loss to net cash used in operating activities:		
Allowance of bad debt	11	(1)
Inventory reserve adjustment	2,588	2,037
Depreciation and amortization	5,329	6,108
Amortization of debt issuance costs	306	211
Gain (loss) on disposal of assets	3	(39)
Share-based compensation	2,290	2,472
Unrealized foreign exchange (gain) loss	(1,065)	997
Changes in operating assets and liabilities:		
Accounts receivable, trade	4,365	(223)
Notes receivable	(742)	6,986
Prepaid income tax	—	1
Inventories	7,403	(1,978)
Other current assets	(80)	(1,422)
Operating right of use asset	230	243
Accounts payable	(9,427)	(406)
Accrued liabilities	(3,815)	(2,271)
Unearned revenue	(237)	—
Lease liability	(257)	(256)
Net cash used in operating activities	<u>(9,390)</u>	<u>(3,603)</u>
Investing activities:		
Purchase of property, plant and equipment	(575)	(1,022)
Proceeds from disposal of equipment	65	115
Deposits and prepaid for equipment	(160)	(30)
Purchase of intangible assets	(113)	(114)
Net cash used in investing activities	<u>(783)</u>	<u>(1,051)</u>
Financing activities:		
Principal payments of long-term debt and notes payable	—	(170)
Proceeds from line of credit borrowings	19,482	41,395
Repayments of line of credit borrowings	(25,402)	(39,062)
Proceeds from bank acceptance payable	18,974	9,686
Repayments of bank acceptance payable	(12,293)	(7,968)
Principal payments of financing lease	(5)	(5)
Payments of tax withholding on behalf of employees related to share-based compensation	(75)	(140)
Proceeds from common stock offering, net	407	—
Net cash provided by financing activities	<u>1,088</u>	<u>3,736</u>
Effect of exchange rate changes on cash	446	(110)
Net decrease in cash, cash equivalents and restricted cash	(8,639)	(1,028)
Cash, cash equivalents and restricted cash at beginning of period	35,587	41,136
Cash, cash equivalents and restricted cash at end of period	<u>26,948</u>	<u>40,108</u>
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest, net of amounts capitalized	\$ 2,304	\$ 2,406
Non-cash investing and financing activities:		
Net change in accounts payable related to property and equipment additions	(20)	19
Net change in deposits and prepaid for equipment related to property and equipment additions	(93)	13

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

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") is a Delaware corporation. The Company is a leading, vertically integrated provider of fiber-optic networking products, primarily for four networking end-markets: cable television ("CATV"), internet data center, telecommunications ("telecom") and fiber-to-the-home ("FTTH"). 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. In the U.S., 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. In addition, the Company also has a research and development facility in Duluth, Georgia. 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 operates a branch in Taipei, Taiwan, which primarily manufactures transceivers and performs research and development activities for the transceiver products. Prime World is also the parent of Global Technology, Inc. ("Global", incorporated in the People's Republic of China). Through Global, the Company primarily manufactures certain of its data center transceiver products, including subassemblies, as well as CATV systems and equipment, and performs research and development activities for the CATV products.

Interim Financial Statements

The unaudited condensed consolidated financial statements of the Company as of March 31, 2023 and December 31, 2022 and for the three months ended March 31, 2023 and March 31, 2022, 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, 2022. The results of operations for the three months ended March 31, 2023 are not necessarily indicative of the results expected for the entire fiscal year. All significant inter-company 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, impairment of long-lived assets, service and product warranty costs, share-based compensation expense, estimated useful lives of property and equipment, and taxes.

Divestiture Agreement with Yuhan Optoelectronic Technology (Shanghai) Co., Ltd

On September 15, 2022, the Company entered into a definitive purchase agreement with Yuhan Optoelectronic Technology (Shanghai) Co., Ltd ("Purchaser"), which is a company incorporated in the People's Republic of China ("PRC"), to divest the Company's manufacturing facilities in PRC and certain assets related to its transceiver business and multi-channel optical sub-assembly products (collectively, the "Divestiture"). The closing of the transaction is subject to the satisfaction of certain closing conditions, including the approval from the Committee on Foreign Investment in the United States ("CFIUS").

The purchase price will be an amount equal to the \$150 million USD equivalent of Renminbi, less a holdback amount. Prior to the closing of the transaction the Company anticipates investing an amount equal to between 4% and 10% of the estimated proceeds from the transaction in exchange for a 10% equity interest in the Purchaser.

Our management has performed an evaluation as required by ASC-360-10-45-9 to determine whether to classify certain of our assets and liabilities as held for sale as of March 31, 2023. ASC 360 requires that a company classifies a business as held for sale in the period in which management commits to a plan to sell the business, the business is available for immediate sale in its present condition, an active program to complete the plan to sell the business is initiated, the sale of the business within one year is probable and the business is being marketed at a reasonable price in relation to its fair value. Although we have announced the execution of a definitive purchase agreement regarding the Divestiture, completion of this transaction is not certain for reasons that include the fact that the proposed sale is subject to regulatory approval in the US and China, the timing and likelihood of which is uncertain and beyond our control, and the fact that we cannot be certain that the buyer will not request modification of terms within the definitive purchase agreement. As a result, we have concluded that at the present time the business is not "available for immediate sale" under the meaning defined in ASC 360 and therefore none of our assets or liabilities should be classified as held for sale.

Note 2. Significant Accounting Policies

There have been no changes in the Company's significant accounting policies for the three months ended March 31, 2023, as compared to the significant accounting policies described in its 2022 Annual Report.

Recent Accounting Pronouncements

Recent Accounting Pronouncements Yet to be Adopted

To date, there have been no recent accounting pronouncement not yet effective that have significance, or potential significance, to our Consolidated Financial Statements.

Note 3. Revenue Recognition*Disaggregation of Revenue*

Revenue is classified based on the location where the product is manufactured. For additional information on the disaggregated revenues by geographical region, see Note 17, "Geographic Information."

Revenue is also classified by major product category and is presented below (in thousands):

	Three months ended March 31,			
	2023	% of Revenue	2022	% of Revenue
CATV	\$ 27,779	52.4%	\$ 24,980	47.8%
Data Center	20,353	38.4%	21,415	41.0%
Telecom	3,707	7.0%	5,265	10.1%
FTTH	2	0.0%	98	0.2%
Other	1,189	2.2%	484	0.9%
Total Revenue	<u>\$ 53,030</u>	<u>100.0%</u>	<u>\$ 52,242</u>	<u>100.0%</u>

Note 4. Leases

The Company leases space under non-cancellable operating leases for manufacturing facilities, research and development offices and certain storage facilities and apartments. These leases do not contain contingent rent provisions. The Company also leases certain machinery, office equipment and a vehicle under an operating lease. Many of its leases include both lease (e.g. fixed payments including rent, taxes, and insurance costs) and non-lease components (e.g. common-area or other maintenance costs) which are accounted for as a single lease component as the Company has elected the practical expedient to group lease and non-lease components for all leases. Several of the leases include one or more options to renew which have been assessed and either included or excluded from the calculation of the lease liability of the right of use ("ROU") asset based on management's intentions and individual fact patterns. Several warehouses and apartments have non-cancellable lease terms of less than one-year and therefore, the Company has elected the practical expedient to exclude these short-term leases from its ROU asset and lease liabilities.

As most of the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate, which is the rate incurred to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment. Based on the applicable lease terms and current economic environment, the Company applies a location approach for determining the incremental borrowing rate.

Lease expense is included under general and administrative expenses and was \$0.3 million each for the periods ended March 31, 2023 and March 31, 2022. The components of lease expense were as follows for the periods indicated (in thousands):

	Three months ended March 31,	
	2023	2022
Operating lease expense	\$ 282	\$ 306
Financing lease expense	8	8
Short Term lease expense	3	3
Total lease expense	<u>\$ 293</u>	<u>\$ 317</u>

Maturities of lease liabilities are as follows for the future one-year periods ending March 31, 2023 (in thousands):

	Operating	Financing
2023	1,221	60
2024	1,136	-
2025	1,151	-
2026	1,076	-
2027	1,099	-
2028 and thereafter	1,289	-
Total lease payments	<u>6,971</u>	<u>60</u>
Less imputed interest	(629)	(2)
Present value	<u>6,342</u>	<u>58</u>

The weighted average remaining lease term and discount rate for the leases were as follows for the periods indicated:

	Three months ended March 31,	
	2023	2022
Weighted Average Remaining Lease Term (Years) - operating leases	5.96	6.91
Weighted Average Remaining Lease Term (Years) - financing leases	0.58	1.58
Weighted Average Discount Rate - operating leases	3.20%	3.22%
Weighted Average Discount Rate - financing leases	5.00%	5.00%

Supplemental cash flow information related to the leases was as follows for the periods indicated (in thousands):

	Three months ended March 31,	
	2023	2022
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	309	314
Operating cash flows from financing lease	1	1
Financing cash flows from financing lease	5	5

Note 5. Cash, Cash Equivalents and Restricted Cash

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the statement of financial position that sum to the total of the same such amounts in the statement of cash flows (in thousands):

	March 31, 2023	December 31, 2022
Cash and cash equivalents	\$ 16,103	\$ 24,685
Restricted cash	10,845	10,902
Total cash, cash equivalents and restricted cash shown in the statement of cash flows	\$ 26,948	\$ 35,587

Restricted cash includes guarantee deposits for customs duties, China government subsidy fund, and compensating balances associated with certain credit facilities. As of March 31, 2023 and December 31, 2022, there was \$8.4 million and \$8.7 million of restricted cash required for bank acceptance notes issued to vendors, respectively. In addition, there was \$1.0 million and \$1.1 million certificate of deposit associated with credit facilities with a bank in China as of March 31, 2023 and December 31, 2022, respectively. There was \$1.4 million and \$1.0 million guarantee deposits for customs duties as of March 31, 2023 and December 31, 2022, respectively.

Note 6. Earnings (Loss) Per Share

Basic net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from stock options, restricted stock units and senior convertible notes outstanding during the period. In periods with net losses, normally dilutive shares become anti-dilutive. Therefore, basic and diluted loss per share are the same.

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

	Three months ended March 31,	
	2023	2022
Numerator:		
Net loss	\$ (16,292)	\$ (16,062)
Denominator:		
Weighted average shares used to compute net loss per share		
Basic	28,872	27,463
Diluted	28,872	27,463
Net loss per share		
Basic	\$ (0.56)	\$ (0.58)
Diluted	\$ (0.56)	\$ (0.58)

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

	Three months ended March 31,	
	2023	2022
Employee stock options	—	—
Restricted stock units	458	—
Shares for convertible senior notes	4,587	4,587
Total antidilutive shares	5,045	4,587

Note 7. Inventories

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

	<u>March 31, 2023</u>	<u>December 31, 2022</u>
Raw materials	\$ 21,315	\$ 25,732
Work in process and sub-assemblies	33,614	39,563
Finished goods	15,257	14,384
Total inventories	<u>\$ 70,186</u>	<u>\$ 79,679</u>

For the three months ended March 31, 2023 and 2022, the inventory reserve adjustment expensed for inventory was \$2.6 million, and \$2.0 million, respectively. For the three months ended March 31, 2023 and 2022, the direct inventory write-offs related to scrap, discontinued products, and damaged inventories were \$3.8 million, and \$1.0 million, respectively.

Note 8. Property, Plant & Equipment

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

	<u>March 31, 2023</u>	<u>December 31, 2022</u>
Land improvements	\$ 806	\$ 806
Buildings and improvements	86,889	86,372
Machinery and equipment	252,892	251,216
Furniture and fixtures	5,434	5,382
Computer equipment and software	11,815	11,713
Transportation equipment	686	679
	<u>358,522</u>	<u>356,168</u>
Less accumulated depreciation and amortization	(183,003)	(177,519)
	<u>175,519</u>	<u>178,649</u>
Construction in progress	30,551	30,434
Land	1,101	1,101
Total property, plant and equipment, net	<u>\$ 207,171</u>	<u>\$ 210,184</u>

For the three months ended March 31, 2023 and 2022, the depreciation expense of property, plant and equipment was \$5.2 million and \$6.0 million, respectively. For the three months ended March 31, 2023 and 2022, the capitalized interest was \$0 million and \$0.1 million, respectively.

As of March 31, 2023, the Company concluded that its continued loss history constitutes a triggering event as described in ASC 360-10-35-21, *Property, Plant, and Equipment*. The Company performed a recoverability test and concluded that future undiscounted cash flows exceed the carrying amount of the Company's long-lived assets and therefore no impairment charge was recorded.

Note 9. Intangible Assets, net

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

	March 31, 2023		
	Gross Amount	Accumulated amortization	Intangible assets, net
Patents	\$ 9,111	\$ (5,493)	\$ 3,618
Trademarks	60	(23)	37
Total intangible assets	\$ 9,171	\$ (5,516)	\$ 3,655

	December 31, 2022		
	Gross Amount	Accumulated amortization	Intangible assets, net
Patents	\$ 8,994	\$ (5,330)	\$ 3,664
Trademarks	56	(21)	35
Total intangible assets	\$ 9,050	\$ (5,351)	\$ 3,699

For the three months ended March 31, 2023 and 2022, amortization expense for intangible assets, included in general and administrative expenses on the statement of operations, was each \$0.2 million. The remaining weighted average amortization period for intangible assets is approximately 5.7 years.

At March 31, 2023, future amortization expense for intangible assets for future one year periods is estimated to be (in thousands):

2023	477
2024	636
2025	636
2026	636
2027	636
2028 and thereafter	634
	<u>3,655</u>

Note 10. Fair Value of Financial Instruments

The carrying value amounts of cash and cash equivalents, restricted cash, accounts receivable, prepaid expenses, notes receivable and other current assets, accounts payable, accrued expenses, bank acceptance payable and other current liabilities approximate fair value because of the short-term maturity of these instruments. The Company believes that the interest rates in effect at each period end represent the current market rates for similar borrowings.

The fair value of convertible senior notes is measured for disclosure purposes only. The fair value and carrying amount of our convertible senior notes as of March 31, 2023 was \$60.9 million and \$79.9 million, respectively. As of December 31, 2022, the fair value and carrying amount of our convertible senior notes was \$58.3 million and \$79.5 million, respectively. The fair value is based on observable market prices for this debt, which is traded in less active markets and are therefore classified as a Level 2 fair value measurement.

Note 11. Notes Payable and Long-Term Debt

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

	March 31, 2023	December 31, 2022
Revolving line of credit with a U.S. bank up to \$27.780 million with interest at 9.663%, maturing the earlier of either 12/14/2023 or 11/16/2025 if the convertible debt remains in effect	20,520	25,000
Revolving line of credit with a China bank up to \$19,037 with interest from 4.57% to 6.12%, maturing May 24, 2024	12,918	13,102
Credit facility with a China bank up to \$26,651 with interest of 4.45% ~ 6.6%, maturing June 6, 2027	17,828	20,140
Credit facility with a China bank up to \$728 with interest of 2.7%, maturing November 23, 2023	728	-
Sub-total	<u>51,994</u>	<u>58,242</u>
Less debt issuance costs, net	(1,073)	(1,168)
Grand total	<u>50,921</u>	<u>57,074</u>
Less current portion	(50,921)	(57,074)
Non-current portion	<u>\$ -</u>	<u>\$ -</u>

Bank Acceptance Notes Payable

Bank acceptance notes issued to vendors with a zero percent interest rate	\$ 19,196	\$ 12,337
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The current portion of long-term debt is the amount payable within one year of the balance sheet date of March 31, 2023.

Maturities of long-term debt are as follows for the future one-year periods ending March 31, (in thousands):

Within one year	\$ 50,921
Beyond one year	-
Total outstanding	<u>\$ 50,921</u>

On November 16, 2022, the Company entered into a Loan Security and Guarantee Agreement (the "Credit Facility") with CIT Northbridge Credit, LLC, as agent for secured parties. The Credit Facility provides the Company with a three-year, \$27.78 million revolving line of credit. Borrowings under the Credit Facility will be used for working capital needs, capital expenditures, and other corporate purposes. The Company's obligations under the Credit Facility are secured by the Company's inventory, accounts receivable, instruments, equipment, intellectual property, and all business assets with the exception of real estate and all foreign assets. Borrowings will bear interest at a rate equal to the Secured Overnight Financing Rate (SOFR) plus 3.75%, while monthly average usage is less than 50% of the Credit Facility, otherwise SOFR plus 4.75%. The Credit Facility will become due at the earlier date of either November 16, 2025 or 91 days prior to the maturity of the Convertible Notes. As of March 31, 2023, \$20.5 million was outstanding under the Credit Facility.

On May 24, 2019, the Company's China subsidiary, Global, entered into a five-year revolving credit line agreement, totaling 180,000,000 RMB (the "SPD Credit Line"), or approximately \$25.4 million at that time, and a mortgage security agreement (the "Security Agreement"), with Shanghai Pudong Development Bank Co., Ltd ("SPD"). Borrowing under the SPD Credit Line will be used for general corporate and capital investment purposes, including the issuance of bank acceptance notes to Global's vendors. Global may draw upon the SPD Credit Line on an as-needed basis at any time during the 5-year term; however, draws under the SPD Credit Line may become due and repayable to SPD at SPD's discretion due to changes in Chinese government regulations and/or changes in Global's financial and operational condition. Each draw will bear interest equal to SPD's commercial banking interest rate effective on the day of the applicable draw. Global's obligations under the SPD Credit Line will be secured by real property owned by Global and mortgaged to the Bank under the terms of the Security Agreement. As of March 31, 2023, \$12.9 million was outstanding under the SPD Credit Line and the outstanding balance of bank acceptance notes issued to vendors was \$14.0 million.

On June 7, 2022, the Company's China Subsidiary, Global, entered a security agreement with China Zheshang Bank in Ningbo City, China ("CZB") for a five-year credit line agreement, totaling 200,000,000 RMB (the "¥200M Credit Facility"), or approximately \$29.9 million at that time. Global may draw upon the ¥200M Credit Facility between June 7, 2022 and June 6, 2027 (" ¥200M Credit Period"). During the ¥200M Credit Period, Global may request to draw upon the ¥200M Credit Facility on an as-needed basis; however, draws under the ¥200M Credit Facility may become due and repayable to CZB at CZB's discretion due to changes in Chinese government regulations and/or changes in Global's financial and operational condition. Each draw will be facilitated by a separate credit agreement specifying the terms of each draw and will bear interest equal to CZB's commercial banking interest rate effective on the day of the applicable draw. Global's obligations under the ¥200M Credit Facility will be secured by real property owned by Global and mortgaged to CZB under the terms of the Real Estate Security Agreement. As of March 31, 2023, \$17.8 million was outstanding under the ¥200M Credit Facility and the outstanding balance of bank acceptance notes issued to vendors was \$5.2 million.

As of March 31, 2023 and December 31, 2022, the Company had \$19.4 million and \$13.3 million of unused borrowing capacity, respectively.

As of March 31, 2023 and December 31, 2022, there was \$9.4 million and \$9.9 million of restricted cash, investments or security deposits associated with the loan facilities, respectively.

Note 12. Convertible Senior Notes

On March 5, 2019, the Company issued \$80.5 million of 5% convertible senior notes due 2024 (the “Notes”). The Notes were issued pursuant to an indenture, dated as of March 5, 2019 (the “Indenture”), between the Company and Wells Fargo Bank, National Association, as trustee, paying agent, and conversion agent (the “Trustee”). The Notes bear interest at a rate of 5.00% per year, payable in cash semi-annually in arrears on March 15 and September 15 of each year, beginning on September 15, 2019. The Notes will mature on March 15, 2024, unless earlier repurchased, redeemed or converted in accordance with their terms.

The sale of the Notes generated net proceeds of \$76.4 million, after deducting the Initial Purchasers’ discounts and offering expenses payable by the Company. The Company used approximately \$37.8 million of the net proceeds from the offering to fully repay the CapEx Loan and Term Loan with Truist Bank and the remainder will be used for general corporate purposes.

The following table presents the carrying value of the Notes for the periods indicated (in thousands):

	March 31, 2023	December 31, 2022
Principal	\$ 80,500	\$ 80,500
Unamortized debt issuance costs	(790)	(994)
Net carrying amount	<u>\$ 79,710</u>	<u>\$ 79,506</u>

The Notes are convertible at the option of holders of the Notes at any time until the close of business on the scheduled trading day immediately preceding the maturity date. Upon conversion, holders of the Notes will receive shares of the Company’s common stock, together, if applicable, with cash in lieu of any fractional share, at the then-applicable conversion rate. The initial conversion rate is 56.9801 shares of the Company’s common stock per \$1,000 principal amount of Notes (representing an initial conversion price of approximately \$17.55 per share of common stock, which represents an initial conversion premium of approximately 30% above the closing price of \$13.50 per share of the Company’s common stock on February 28, 2019), subject to customary adjustments. If a make-whole fundamental change (as defined in the Indenture) occurs, and in connection with certain other conversions before March 15, 2022, the Company will in certain circumstances increase the conversion rate for a specified period of time.

Initially and as of March 31, 2023 there are no guarantors of the Notes, but the Notes will be fully and unconditionally guaranteed, on a senior, unsecured basis by certain of the Company’s future domestic subsidiaries. The Notes are the Company’s senior, unsecured obligations and are equal in right of payment with existing and future senior, unsecured indebtedness, senior in right of payment to the Company’s existing and future indebtedness that is expressly subordinated to the Notes and effectively subordinated to the Company’s existing and future secured indebtedness, to the extent of the value of the collateral securing that indebtedness. The Note Guarantee (as defined in the Indenture) of each future guarantor, if any, will be such guarantor’s senior, unsecured obligations and are equal in right of payment with existing and future senior, unsecured indebtedness, senior in right of payment to such future guarantor’s existing and future indebtedness that is expressly subordinated to the Notes and effectively subordinated to such future guarantor’s existing and future secured indebtedness, to the extent of the value of the collateral securing that indebtedness.

Holders may require the Company to repurchase their Notes upon the occurrence of a fundamental change (as defined in the Indenture) at a cash purchase price equal to the principal amount thereof plus accrued and unpaid interest, if any.

After March 15, 2022, the Company may redeem for cash all or part of the Notes if the last reported sale price per share of the Company’s common stock exceeds 130% of the conversion price on (i) each of at least 20 trading days, whether or not consecutive, during the 30 consecutive trading days ending on, and including, the trading day immediately before the date the Company sends the related redemption notice; and (ii) the trading day immediately before the date the Company sends such redemption notice. The redemption price is equal to 100% of the principal amount of the notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date. In addition, calling any Note for redemption will constitute a “make-whole fundamental change” with respect to that Note, in which case the conversion rate applicable to the conversion of that Note will be increased in certain circumstances if it is converted after it is called for redemption.

The Indenture contains covenants that limit the Company’s ability and the ability of our subsidiaries to, among other things: (i) incur or guarantee additional indebtedness or issue disqualified stock; and (ii) create or incur liens.

Pursuant to the guidance in ASC 815-40, Contracts in Entity’s Own Equity, the Company evaluated whether the conversion feature of the note needed to be bifurcated from the host instrument as a freestanding financial instrument. Under ASC 815-40, to qualify for equity classification (or non-bifurcation, if embedded) the instrument (or embedded feature) must be both (1) indexed to the issuer’s own stock and (2) meet the requirements of the equity classification guidance. Based upon the Company’s analysis, it was determined the conversion option is indexed to its own stock and also met all the criteria for equity classification contained in ASC 815-40-25-7 and 815-40-25-10. Accordingly, the conversion option is not required to be bifurcated from the host instrument as a freestanding financial instrument. Since the conversion feature meets the equity scope exception from derivative accounting, the Company then evaluated whether the conversion feature needed to be separately accounted for as an equity component under ASC 470-20, Debt with Conversion and Other Options. The Company determined that notes should be accounted for in their entirety as a liability.

The Company incurred approximately \$4.1 million in transaction costs in connection with the issuance of the Notes. These costs were recognized as a reduction of the carrying amount of the Notes utilizing the effective interest method and are being amortized over the term of the Notes.

The following table sets forth interest expense information related to the Notes (in thousands):

	Three months ended March 31,	
	2023	2022
Contractual interest expense	\$ 1,006	\$ 1,006
Amortization of debt issuance costs	204	204
Total interest cost	\$ 1,210	\$ 1,210
Effective interest rate	5.1%	5.1%

Note 13. Accrued Liabilities

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

	March 31, 2023	December 31, 2022
Accrued payroll	\$ 6,952	\$ 9,702
Accrued employee benefits	3,208	3,265
Accrued state and local taxes	570	588
Accrued interest	635	1,597
Accrued shipping and tariff expenses	2	—
Advanced payments	200	216
Accrued commission expenses	940	937
Accrued professional fees	207	409
Accrued product warranty	125	140
Accrued capital expenditure	20	—
Accrued other	646	368
Total accrued liabilities	\$ 13,505	\$ 17,222

Note 14. Other Income and Expense

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

	Three months ended March 31,	
	2023	2022
Foreign exchange transaction gain (loss)	\$ (237)	\$ (523)
Government subsidy income	118	18
Other non-operating gain	101	16
Gain (loss) on disposal of assets	(3)	39
Total other income (expenses) , net	\$ (21)	\$ (450)

Note 15. Share-Based Compensation

Equity Plans

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

- the 2013 Equity Incentive Plan ("2013 Plan")
- the 2021 Equity Incentive Plan ("2021 Plan")

The Company issued stock options, restricted stock awards ("RSAs") and restricted stock 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 two 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.

The following is a summary of option activity:

	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
(in thousands, except price data)						
Outstanding at January 1, 2023	263	\$ 10.41		\$ 5.45	0.71	\$ -
Exercised	-	-		-	-	-
Forfeited	(34)	7.50		4.73	-	-
Outstanding, March 31, 2023	229	10.84		5.56	0.57	-
Exercisable, March 31, 2023	229	10.84		5.56	0.57	-
Vested and expected to vest	229	10.84		5.56	0.57	-

As of March 31, 2023, there was no unrecognized stock option expense.

Performance Based Incentive Plan

The Company approved to grant restricted performance stock units ("PSUs") to senior executives as a part of our long-term equity compensation program starting from June 2021. The number of shares of common stock that will ultimately be issued to settle PSUs granted ranges from 0% to 200% of the number granted and is determined based on certain performance criteria over a three-year measurement period. The performance criteria for the PSUs are based on a combination of the performance of our stock price and the Total Shareholder Return ("TSR") for the performance period compared with the TSR of certain peer companies or index for the performance period. PSUs granted vest 100% on the third anniversary of their grant, assuming achievement of the applicable performance criteria. We estimated the fair value of the PSUs using a Monte Carlo simulation model on the date of grant. Compensation expense is recognized ratably over the explicit service period. The Company recognized PSU expenses for the three months ended on March 31, 2023 and 2022 of \$0.4 million and \$0.3 million, respectively.

The following is a summary of PSU activity:

	Number of shares	Weighted Average Share Price on Date of Release	Weighted Average Fair Value	Aggregate Intrinsic Value
(in thousands, except price data)				
Outstanding at January 1, 2023	766		\$ 6.75	\$ 1,447
Granted	0		0	0
Released	0		0	0
Cancelled/Forfeited	0		0	0
Outstanding, March 31, 2023	766		6.75	1,692
Vested and expected to vest	766		6.75	1,692

As of March 31, 2023, there was \$2.4 million of unrecognized compensation expense related to these PSUs. This expense is expected to be recognized over 1.4 years.

Restricted Stock Units

The following is a summary of RSU activity:

Weighted Average Share	Weighted	Aggregate
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	<u>Number of shares</u>	<u>Price on Date of Release</u>	<u>Average Fair Value</u>	<u>Intrinsic Value</u>
		(in thousands, except price data)		
Outstanding at January 1, 2023	2,210		\$ 5.76	\$ 4,175
Granted	27		2.70	73
Released	(326)		6.94	765
Cancelled/Forfeited	(47)		3.78	103
Outstanding, March 31, 2023	<u>1,864</u>		5.56	4,120
Vested and expected to vest	<u>1,864</u>		5.56	4,120

As of March 31, 2023, there was \$9.1 million of unrecognized compensation expense related to these RSUs. This expense is expected to be recognized over 1.9 years.

Share-Based Compensation

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

	Three months ended March 31,	
	2023	2022
Share-based compensation - by expense type		
Cost of goods sold	\$ 114	\$ 136
Research and development	297	365
Sales and marketing	195	226
General and administrative	1,684	1,745
Total share-based compensation expense	<u>\$ 2,290</u>	<u>\$ 2,472</u>

Note 16. Income Taxes

The Company's effective tax rate for the three months ended March 31, 2023 and 2022 was 0%. For the three months ended March 31, 2023 and 2022, the effective tax rate varied from the federal statutory rate of 21% primarily due to the change of the valuation allowance on federal, state, Taiwan, and China deferred tax assets ("DTA").

The Company continually monitors and performs an assessment of the realizability of its DTAs, including an analysis of factors such as future taxable income, reversal of existing taxable temporary differences, and tax planning strategies. In assessing the need for a valuation allowance, the Company considered both positive and negative evidence related to the likelihood of realization of deferred tax assets using a "more likely than not" standard. In making such assessment, more weight was given to evidence that could be objectively verified, including recent cumulative losses. Based on the Company's review of this evidence, management determined that a full valuation allowance against all of the Company's net deferred tax assets at March 31, 2023 was appropriate.

Note 17. 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 March 31,	
	2023	2022
Revenues:		
United States	\$ 6,439	\$ 2,559
Taiwan	42,386	27,779
China	4,205	21,904
	<u>\$ 53,030</u>	<u>\$ 52,242</u>
	As of the period ended	
	March 31,	December 31,
	2023	2022
Long-lived assets:		
United States	\$ 78,048	\$ 80,048
Taiwan	49,628	50,777
China	93,828	93,888
	<u>\$ 221,504</u>	<u>\$ 224,713</u>

Note 18. 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.

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.

Other Contingencies

On August 9, 2021, the Company has received a Taxes Notification of Audit Result (“Notice”) from the Texas Comptroller’s Office (the “Comptroller”), for fiscal years between 2016 and 2019, informing the Company that the Comptroller believes the Company did not qualify for certain sales and use tax exemptions on various Research and Development purchases and accordingly the Company is liable for Sale and Use Tax in the amount of approximately \$1.0 million including interest charges. The Company paid \$0.4 million for the tax notice in May 2021, but challenged the remaining tax assessments and vigorously defended its position. The Comptroller’s office exhausted its redetermination period and therefore moved AOI’s case to the hearing process. In April 2023 the Company received a notice from an attorney representing the Administrative Hearings Section (“AHS”) to issue a Position Letter.

Note 19. Subsequent Events

The Company repaid its revolving bank line of credit with CIT Northbridge Credit, LLC in the amount of \$2 million on April 3, 2023.

In April 2023, the Company received notice from the California Department of Tax and Fee Administration regarding a sales tax audit to be performed in May 2023 for the period from January 1, 2020 through December 31, 2022. This is in the early stages and the audit has not begun, therefore management is unable to assess if any incremental taxes, interest or penalties would be due.

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 March 31, 2023 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, 2022 included in our Annual Report. 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, including our Report on Form 10-K for the year ended December 31, 2022 and subsequent Quarterly Reports on Form 10-Q. 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. We target four networking end-markets: CATV, internet data centers, telecom and FTTH. 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 typically 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 the CATV, internet data center, telecom and FTTH markets which increasingly demand faster connectivity and innovation. 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.

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. Within the CATV market, we benefit from a number of ongoing trends including the build-out of CATV infrastructure in the US and other countries, the move to higher bandwidth networks among CATV service providers and the outsourcing of system design among CATV networking equipment companies. Within the internet data center market, we benefit from the increasing use of higher-capacity optical networking technology as a replacement for copper cables, particularly as speeds reach 100 Gbps and above, as well as the movement to open internet data center architectures and the increasing use of in-house equipment design among leading internet companies. In the FTTH market, we benefit from continuing PON deployments and system upgrades among telecom service providers. In the telecom market, we benefit from deployment of new high-speed fiber-optic networks by telecom network operators, including 5G networks.

Our vertically integrated manufacturing model provides us several advantages, including rapid product development, fast response times to customer requests and greater 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 we manufacture are tested extensively to enable reliable operation over time and our devices are often highly tolerant of changes in temperature and humidity, making them well-suited to the CATV, FTTH and 5G telecom markets where networking equipment is often installed outdoors.

We have three manufacturing sites: Sugar Land, Texas, Ningbo, China and Taipei, Taiwan. Our research and development functions are generally partnered with our manufacturing locations, and we have an additional research and development facility in Duluth, Georgia. In our Sugar Land facility, we manufacture laser chips (utilizing our MBE and MOCVD processes), 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 Sugar Land facility. Additionally, in our Taiwan location, we manufacture transceivers for the internet data center, telecom, FTTH 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 and transceivers for the CATV transmitters (at the headend), CATV outdoor equipment (at the node) and internet data center market. Each manufacturing facility conducts testing on the components, modules or subsystems it manufactures and each facility is certified to ISO 9001:2015. Our facilities in Ningbo, China, Taipei, Taiwan, and Sugar Land, Texas are all certified to ISO 14001:2015.

Our business depends on winning competitive bid selection processes to develop components, systems and equipment for use in our customers' products. These selection processes are typically lengthy, and as a result our sales cycles will vary based on the level of customization required, market served, whether the design win is with an existing or new customer and whether our solution being designed in our customers' product is our first generation or subsequent generation product. We do not have any long-term purchase commitments (in excess of one year) with any of our customers, most of whom purchase our products on a purchase order basis. However, once one of our solutions is incorporated into a customer's design, we believe that our solution is likely to continue to be purchased for that design throughout that product's life cycle because of the time and expense associated with redesigning the product or substituting an alternative solution.

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

Divestiture Agreement with Yuhan Optoelectronic Technology (Shanghai) Co., Ltd

On September 15, 2022, we entered into a definitive purchase agreement and announced the planned divestiture to sell the manufacturing facilities in the People's Republic of China ("PRC") and certain assets related to our transceiver business and multi-channel optical sub-assembly products to Yuhan Optoelectronic Technology (Shanghai) Co., Ltd. ("Purchaser"), which is a company incorporated in the PRC. The transaction is expected to close in late 2023 or 2024 subject to satisfaction of certain closing conditions, including CFIUS approval.

The purchase price will be an amount equal to the \$150 million USD equivalent of Renminbi, less a holdback amount. Prior to the closing of the transaction the Company anticipates investing an amount equal to between 4% and 10% of the estimated proceeds from the transaction in exchange for a 10% equity interest in the Purchaser. The proceeds from the transaction will enable the Company to make strategic investments in higher margin and higher growth opportunities. By exiting the transceiver market, the Company will focus its resources on its CATV business and manufacturing lasers and laser components for the CATV, datacenter, telecom and FTTH markets.

Our management has performed an evaluation as required by ASC-360-10-45-9 to determine whether to classify certain of our assets and liabilities as held for sale as of March 31, 2023. ASC 360 requires that a company classifies a business as held for sale in the period in which management commits to a plan to sell the business, the business is available for immediate sale in its present condition, an active program to complete the plan to sell the business is initiated, the sale of the business within one year is probable and the business is being marketed at a reasonable price in relation to its fair value. Although we have announced the execution of a definitive purchase agreement regarding the Divestiture, completion of this transaction is not certain for reasons that include the fact that the proposed sale is subject to regulatory approval in the US and China, the timing and likelihood of which is uncertain and beyond our control, and the fact that we cannot be certain that the buyer will not request modification of terms within the definitive purchase agreement. As a result, we have concluded that at the present time the business is not "available for immediate sale" under the meaning defined in ASC 360 and therefore none of our assets or liabilities should be classified as held for sale.

COVID-19 Pandemic

The COVID-19 pandemic has had, and continues to have, a significant impact around the world. We are subject to risks and uncertainties as a result of the COVID-19 pandemic. The extent of the impact of the COVID-19 pandemic on our business is highly uncertain and difficult to predict as COVID-19 continues to spread around the world. In March 2020, we instituted travel restrictions and implemented sanitation and disinfection procedures to safeguard the health and safety of our employees which continue today. With increased vaccinations and the potential reduction of infections, we implemented procedures for a safe return to the office environment for all of our employees in 2021. China experienced the world's largest COVID-19 surge of the pandemic in December 2022 after the end of the zero-COVID policy. Yet there is minimum impact to the labor force in China due to less government restrictions on quarantine and testing.

The spread of COVID-19 has impacted our supply chain operations through restrictions, reduced capacity and shutdown of business activities by suppliers whom we rely on for sourcing components and materials and third-party partners whom we rely on for manufacturing, warehousing and logistics services. Our supply chain restrictions due to COVID-19 have improved during the latter part of 2022, and we will continue to expect improvements for the remainder of 2023.

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, except percentages):

	Three months ended		Three months ended	
	March 31,		March 31,	
	2023		2022	
Revenue, net	\$ 53,030	100.00%	\$ 52,242	100.0%
Cost of goods sold	43,786	82.57%	43,217	82.7%
Gross profit	9,244	17.43%	9,025	17.3%
Operating expenses				
Research and development	8,536	16.10%	9,486	18.2%
Sales and marketing	2,327	4.39%	2,558	4.9%
General and administrative	12,548	23.66%	11,220	21.5%
Total operating expenses	23,411	44.15%	23,264	44.5%
Loss from operations	(14,167)	(26.72)%	(14,239)	(27.3)%
Other income (expense)				
Interest income	33	0.06%	28	0.1%
Interest expense	(2,137)	(4.03)%	(1,401)	(2.7)%
Other income, net	(21)	(0.04)%	(450)	(0.9)%
Total other income (expense), net	(2,125)	(4.01)%	(1,823)	(3.5)%
Loss before income taxes	(16,292)	(30.72)%	(16,062)	(30.7)%
Income tax expense	-	0.00%	0	0.0%
Net loss	\$ (16,292)	(30.72)%	\$ (16,062)	(30.7)%

Comparison of Financial Results*Revenue*

We generate revenue through the sale of our products to equipment providers and network operators for the CATV, internet data center, telecom and FTTH 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 months ended March 31, 2023 and 2022 (in thousands, except percentages):

	Three months ended March 31,				Change	
	2023	% of Revenue	2022	% of Revenue	Amount	%
CATV	\$ 27,779	52.4%	\$ 24,980	47.8%	\$ 2,799	11.2%
Data Center	20,353	38.4%	21,415	41.0%	(1,062)	(5.0)%
Telecom	3,707	7.0%	5,265	10.1%	(1,558)	(29.6)%
FTTH	2	0.0%	98	0.2%	(96)	(98.0)%
Other	1,189	2.2%	484	0.9%	705	145.7%
Total Revenue	<u>\$ 53,030</u>	<u>100.0%</u>	<u>\$ 52,242</u>	<u>100.0%</u>	<u>\$ 788</u>	<u>1.5%</u>

The increase in revenue during the three months ended March 31, 2023 was driven primarily by strong demand in CATV product sales arising from products with architecture improvements to enable delivery of additional bandwidth to consumers. The increase in bandwidth demand was particularly acute in the upstream direction, and sales of products associated with increased return-path bandwidth were notably strong in the quarter. The increase was offset by the decrease of data center sales and telecom sales.

We have begun to see increased orders for our 400G data center products from several large customers. Based on forecasts from our customers, we expect increased demand for these products through the end of 2023. In the first quarter, we also generated approximately \$4 million in revenue from one of our largest data center customers which was related to furnishing qualification reports to ensure future orders will be fulfilled and expedited. We believe there will be additional such expediting fees in the second quarter and we believe that the customer's willingness to incur these expedite fees implies significant demand for the expedited products for at least the remainder of 2023.

For the three months ended March 31, 2023 and 2022, our top ten customers represented 93% and 88.6% of our revenue, respectively. We believe that diversifying our customer base is critical for our future success, since reliance on a small number of key customers makes our ability to forecast future results dependent upon the accuracy of the forecasts we receive from those key customers. We continue to prioritize new customer acquisition and growth of diverse revenue streams.

Cost of goods sold and gross margin

	Three months ended March 31,					
	2023		2022		Change	
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(in thousands, except percentages)					
Cost of goods sold	\$ 43,786	82.6%	\$ 43,217	82.7%	\$ 569	1.3%
Gross margin	9,244	17.4%	9,025	17.3%	219	2.4%

Cost of goods sold increased by \$0.6 million, or 1.3% for the three months ended March 31, 2023 as compared to the three months ended March 31, 2022, primarily due to the 1.5% sales increase and higher cost of certain raw materials due to global supply chain disruption.

Gross profit increased \$0.2 million, or 2.4% for the three months ended March 31, 2023 as compared to the three months ended March 31, 2022, primarily as a result of higher selling prices for some of our data center products.

Operating expenses

	Three months ended March 31,					
	2023		2022		Change	
	Amount	% of revenue	Amount	% of revenue	Amount	%
	(in thousands, except percentages)					
Research and development	\$ 8,536	16.1%	\$ 9,486	18.2%	\$ (950)	(10.0)%
Sales and marketing	2,327	4.4%	2,558	4.9%	(231)	(9.0)%
General and administrative	12,548	23.7%	11,220	21.5%	1,328	11.8%
Total operating expenses	\$ 23,411	44.1%	\$ 23,264	44.5%	\$ 147	0.6%

Research and development expense

Research and development expense decreased by \$1.0 million, or 10% for the three months ended March 31, 2023 as compared to the three months ended March 31, 2022. Research and development costs consist of R&D work orders, R&D material usage and other project related costs related to 100 Gbps, 200/400 Gbps data center products, DOCSIS 3.1 capable CATV products and other new product development, and depreciation expense resulting from R&D equipment investments. The decreases were primarily due to less share-based compensation expense, and less materials and supplies used in R&D activities combined with Asian currency exchange rate effect.

Sales and marketing expense

Sales and marketing expense decreased by \$0.2 million, or 9.0% for the three months ended March 31, 2023 as compared to the three months ended March 31, 2022. The decrease was primarily due to a decrease in duties and freight and partially offset by an increase in miscellaneous tax expenses.

General and administrative expense

General and administrative expense increased by \$1.3 million, or 11.8% for the three months ended March 31, 2023 compared to the three months ended March 31, 2022. This increase was primarily due to an increase in personnel-related costs and professional service fees incurred due to the transaction for China divestiture agreement, taxes and fees. This increase was partially offset by a decrease in share-based compensation expense.

Other income (expense), net

	Three months ended March 31,					
	2023		2022		Change	
	Amount	% of revenue	Amount	% of revenue	Amount	%
	(in thousands, except percentages)					
Interest income	\$ 33	0.1%	\$ 28	0.1%	\$ 5	17.9%
Interest expense	(2,137)	(4.0)%	(1,401)	(2.7)%	(736)	52.5%
Other income (expense), net	(21)	(0.0)%	(450)	(0.9)%	429	(95.3)%
Total other income (expense), net	<u>\$ (2,125)</u>	<u>(4.0)%</u>	<u>\$ (1,823)</u>	<u>(3.5)%</u>	<u>\$ (302)</u>	<u>16.6%</u>

Interest income increased for the three months ended March 31, 2023 compared to the three months ended March 31, 2022. The changes are similar to expected rates of fluctuation with the interest rates and cash balances.

Interest expense increased by \$0.7 million, or 52.5% for the three months ended March 31, 2023 compared to the three months ended March 31, 2022. This increase was due to higher average debt interest rate during the period.

Other expense decreased by \$0.4 million, or 95.3%, for the three months ended March 31, 2023 as compared to the three months ended March 31, 2022. This decrease was mainly due to the other income received in the first quarter of 2023 from the China plant for a local government subsidized income in local city development plan and foreign currency gain arising from favorable exchange rate change.

Benefit (provision) for income taxes

	Three months ended March 31,					
	2023		2022		Change	
	(in thousands, except percentages)					
Benefit (provision) for income taxes	\$ -		\$ -		\$ -	

The Company's effective tax rate for the three months ended March 31, 2023 and 2022 was 0%. For the three months ended March 31, 2023 and 2022, the effective tax rate varied from the federal statutory rate of 21% primarily due to the change of the valuation allowance on federal, state, Taiwan, and China deferred tax assets ("DTA").

On August 9, 2022, the Creating Helpful Incentives to Produce Semiconductors Act ("CHIPS Act") was enacted. Among its provisions, the bill provides various federal grants, tax credits, and incentives for investment in the United States. On August 16, 2022, the Inflation Reduction Act ("IRA") was also signed into law. Among other provisions, the IRA imposes a 15% corporate alternative minimum tax ("Corporate AMT") for tax years beginning after December 31, 2022, imposes a 1% excise tax on corporate stock repurchases after December 31, 2022, and provides tax incentives to promote various energy efficient initiatives. We are evaluating these laws and their potential impact on our current income tax expense and cash taxes. However, we currently do not believe this will have an impact on our taxes for the 2023 tax year.

Comprehensive Loss

	Three months ended March 31,				Change	
	2023		2022		Amount	%
	Amount	% of revenue	Amount	% of revenue		
	(in thousands, except percentages)					
Net (loss)	\$ (16,292)	(30.7)%	\$ (16,062)	(30.2)%	\$ (230)	(1.4)%
Gain (Loss) on foreign currency translation adjustment	1,640	3.1%	(1,262)	(2.4)%	2,902	(230.0)%
Comprehensive (loss)	<u>\$ (14,652)</u>	<u>(27.6)%</u>	<u>\$ (17,324)</u>	<u>(30.5)%</u>	<u>\$ 2,672</u>	<u>(15.4)%</u>

Comprehensive loss decreased by \$2.7 million, or 15.4%, for the three months ended March 31, 2023 as compared to the three months ended March 31, 2022, primarily due to decrease of \$2.9 million in loss on foreign currency translation adjustments for non-U.S. dollar functional currency operations.

The functional currency for the Company's operations is generally the applicable local currency. Accordingly, the assets and liabilities of companies whose functional currency is other than the U.S. dollar are included in the consolidated financial statements by translating the assets and liabilities into the U.S. dollar at the exchange rates applicable at the end of the reporting period. Translation gains or losses are accumulated in other comprehensive income (loss) in the consolidated statements of shareholders' equity and are also included in comprehensive loss.

Liquidity and Capital Resources

As of March 31, 2023, we had \$19.4 million of unused borrowing capacity from all of our loan agreements. As of March 31, 2023, our cash, cash equivalents and restricted cash totaled \$26.9 million. Cash and cash equivalents are held for working capital purposes and are invested primarily in money market or time deposit funds. We do not enter into investments for trading or speculative purposes.

ATM Offerings

On October 24, 2019, we filed a Registration Statement on Form S-3 with the Securities and Exchange Commission, which was declared effective on January 9, 2020, providing for the public offer and sale of certain securities of the Company from time to time, at our discretion, up to an aggregate amount of \$250 million. The unsold securities under this registration were carried forward to the S-3 declared effective in March 2023.

On February 28, 2020, we entered into an Equity Distribution Agreement with Raymond James & Associates, Inc. (the "Sales Agent") pursuant to which the Company may issue and sell shares of the Company's common stock having an aggregate offering price of up to \$55 million (the "Initial ATM Offering"), from time to time through the Sales Agent. In January 2021, the Company completed its Initial ATM Offering and sold 5.9 million shares at a weighted average price of \$9.12 per share, providing proceeds of \$53.9 million, net of expenses and underwriting discounts and commissions. There are no more securities remaining that can be sold under this ATM offering.

On February 26, 2021, we entered into another Equity Distribution Agreement with the Sales Agent pursuant to which the Company may issue and sell shares of the Company's common stock, par value \$0.001 per share having an aggregate offering price of up to \$35 million (the "Second ATM Offering"), from time to time through the Sales Agent. In February 2023, the Company completed its Second ATM Offering and sold 0.7 million shares at a weighted average price of \$3.81 per share, providing proceeds of \$2.6 million, net of expenses and underwriting discounts and commissions. There are no more securities remaining that can be sold under this ATM offering.

The details of the shares of common stock sold through the Second ATM Offering are as follows (in thousands, except shares and weighted average per share price):

Distribution Agent	Month	Number of Shares Sold	Weighted Average Per Share Price	Gross Proceeds	Compensation to Distribution Agent	Net Proceeds
Raymond James & Associates, Inc.	March 2021	65,748	9.0622	\$ 596	12	\$ 584
Raymond James & Associates, Inc.	June 2021	34,686	9.1115	316	6	\$ 310
Raymond James & Associates, Inc.	July 2021	6,740	9.1061	60	1	\$ 59
	September					
Raymond James & Associates, Inc.	2022	94,491	2.9045	274	5	\$ 269
Raymond James & Associates, Inc.	October 2022	313,333	2.8947	907	18	\$ 889
	November					
Raymond James & Associates, Inc.	2022	29,426	2.7830	82	2	\$ 80
Raymond James & Associates, Inc.	February 2023	158,149	2.8111	445	9	\$ 436
Total		702,573		\$ 2,680	53	\$ 2,627

On January 5, 2023, the Company filed a Registration statement on Form S-3 with the Securities and Exchange Commission, which was declared effective on March 21, 2023, providing for the public offer and sale of certain securities of the Company from time to time, at our discretion, up to an aggregate amount of \$185 million. Pursuant to Rule 415(a)(6) under the Securities Act, the securities registered pursuant to this registration statement include unsold securities previously registered for sale pursuant to our previously filed Registration Statement on Form S-3, which became effective on January 9, 2020.

On March 24, 2023, we entered into another Equity Distribution Agreement (the "Agreement") with the Sales Agent pursuant to which the Company may issue and sell shares of the Company's common stock, par value \$0.001 per share (the "Shares") having an aggregate offering price of up to \$35 million (the "Third ATM Offering"), from time to time through the Sales Agent. Upon delivery of a placement notice and subject to the terms and conditions of the Agreement, sales, if any, of the Shares will be made through the Sales Agent in transactions that are deemed to be "at the market" offerings as defined in Rule 415 of the Securities Act of 1933, as amended (the "Securities Act"), including sales made through the facilities of the Nasdaq

Global Market, the principal trading market for the Company's common stock, on any other existing trading market for the Company's common stock, to or through a market maker or as otherwise agreed by the Company and the Sales Agent. In the placement notice, the Company will designate the maximum number of Shares to be sold through the Sales Agent, the time period during which sales are requested to be made, the minimum price for the Shares to be sold, and any limitation on the number of Shares that may be sold in any one day. Subject to the terms and conditions of the Agreement, the Sales Agent will use its commercially reasonable efforts to sell Shares on the Company's behalf up to the designated amount specified in the placement notice. The Company has no obligation to sell any Shares under the Agreement and may at any time suspend offers and sales of the Shares under the Agreement.

The Agreement provides that the Sales Agent will be entitled to compensation of up to 2% of the gross sales price of the Shares sold through the Sales Agent from time to time. The Company has also agreed to reimburse the Sales Agent for certain specified expenses in connection with the registration of Shares under state blue sky laws and any filing with, and clearance of the offering by, the Financial Industry Regulatory Authority Inc., not to exceed \$10,000 in the aggregate, and any associated application fees incurred. Additionally, if the Agreement is terminated under certain circumstances, and the Company fails to sell a minimum amount of the Shares as set forth in the Agreement, then the Company has agreed to reimburse the Sales Agent for reasonable out-of-pocket expenses, including the reasonable fees and disbursements of counsel incurred by the Sales Agent, up to a maximum of \$30,000 in the aggregate. The Company agreed to indemnify the Sales Agent against certain liabilities, including liabilities under the Securities Act, or to contribute to payments that the Sales Agent may be required to make because of any of those liabilities.

As of March 31, 2023, no gross sale has been made through the Third ATM Offering, thus the amount of common stock we have available to sell under the Third ATM Offering is \$35 million.

Note Offering

On March 5, 2019, the Company issued \$80.5 million of 5% convertible senior notes due 2024 (the "Notes"), bearing interest at a rate of 5% per year maturing on March 15, 2024, unless earlier repurchased, redeemed or converted in accordance with their terms. The sale of the Notes generated net proceeds of \$76.4 million, after expenses. Also, refer to Note 12 "Convertible Senior Notes" to the consolidated financial statements for further discussion of the Notes.

Operating activities

The table below sets forth selected cash flow data for the periods presented (in thousands):

	Three months ended March 31,	
	2023	2022
Net cash used in operating activities	\$ (9,390)	\$ (3,603)
Net cash used in investing activities	(783)	(1,051)
Net cash provided by financing activities	1,088	3,736
Effect of exchange rates on cash and cash equivalents	446	(110)
Net increase (decrease) in cash and cash equivalents	<u>\$ (8,639)</u>	<u>\$ (1,028)</u>

For the three months ended March 31, 2023, net cash used in operating activities was \$9.4 million. Net cash used in operating activities consisted of our net loss of \$16.3 million after exclusion of non-cash items of \$9.5 million. Cash decreased due to an increase in accounts receivable of \$4.4 million, an increase in trade receivables from our customers of \$0.7 million together with decrease in accounts payable of \$9.4 million and accrued liabilities of \$3.8 million, respectively, offset with a decrease in inventory of \$7.4 million.

For the three months ended March 31, 2022, net cash used in operating activities was \$3.6 million. Net cash used in operating activities consisted of our net loss of \$16.1 million after exclusion of non-cash items of \$11.8 million. Cash decreased due to a decrease in accrued liabilities of \$2.3 million and an increase in inventory of \$2.0 million, offset by a decrease in trade receivables from our customers of \$7.0 million.

Investing activities

For the three months ended March 31, 2023, net cash used in investing activities was \$0.8 million, mainly from the purchase of additional plant, machinery and equipment.

For the three months ended March 31, 2022, net cash used in investing activities was \$1.1 million, mainly from the purchase of additional plant, machinery and equipment.

Financing activities

For the three months ended March 31, 2023, our financing activities provided \$1.1 million in cash. This increase in cash was due to \$6.7 million of net proceeds from bank acceptances and \$0.4 million of net proceeds from our At The Market (ATM) Offering, offset by the repayment of loan of \$5.9 million lines of credit.

For the three months ended March 31, 2022, our financing activities provided \$3.7 million in cash. This increase in cash was due to \$2.3 million net proceeds from lines of credit and \$1.7 million net proceeds from acceptances payable.

Loans and commitments

We have lending arrangements with several financial institutions. In the US, we have a revolving line of credit with CIT Northbridge Credit, LLC. The line of credit contains financial covenants that may limit the amount and types of debt that we may incur. As of March 31, 2023, we were in compliance with these covenants.

As of March 31, 2023, we had \$19.4 million of unused borrowing capacity.

On March 5, 2019, we issued \$80.5 million of 5% convertible senior notes due in 2024. The Notes will mature on March 15, 2024, unless earlier repurchased, redeemed or converted in accordance with their terms.

See Note 11 "Notes Payable and Long-term Debt" and Note 12 "Convertible Senior Notes" of our Condensed Consolidated Financial Statements for a description of our notes payable and long-term debt and convertible senior notes.

China factory construction

On February 8, 2018, we entered into a construction contract with Zhejiang Xinyu Construction Group Co., Ltd. for the construction of a new factory and other facilities at our Ningbo, China location. Construction costs for these facilities under this contract are estimated to total approximately \$27.5 million. As of March 31, 2023, construction of the building shell is complete, and approximately \$27.4 million of this total cost has been paid and the remaining portion will be paid in yearly installments for three years after final inspection. We anticipate additional expenses for building improvements to the factory and we are in the process of evaluating the timing of these expenditures and obtaining bids for any such work. Based on forecasts, we believe the factory will be placed in service in the year 2024 after the construction is completed for the building interior work. Property will be transferred from construction in progress to building and improvement at that time.

Future liquidity needs

We had cash, cash equivalents and restricted cash of \$26.9 million as of March 31, 2023, a decrease of approximately \$8.6 million compared to December 31, 2022. This cash reduction included repayment of \$5.9 million of our revolving credit facility with CIT, along with changes in current accounts which consumed \$2.6 million in cash. Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support our research and development efforts, the expansion of our sales and marketing activities, the introduction of new and enhanced products, the building improvement of a new factory and other facilities at our Ningbo, China location, changes in our manufacturing capacity and the continuing market acceptance of our products.

As of March 31, 2023, we had a total loan balance (excluding convertible notes) of \$52.0 million from various lenders in the US and China, and had \$19.4 million available borrowing capacity on existing credit lines. Should additional liquidity be needed, our Board has authorized issuance of equity totaling up to \$35 million under our Third ATM Offering (see the discussion of Liquidity and Capital Resources in Item 2, below) to date, no sales have been made under this Third ATM Offering, thus the amount of common stock we have available to sell under this offering is \$35 million.

Also as noted in Item 2, below, on September 15, 2022, the Company entered into a definitive purchase agreement with Yuhan Optoelectronic Technology (Shanghai) Co., Ltd ("Purchaser"), which is a company incorporated in the People's Republic of China ("PRC"), to divest our manufacturing facilities in PRC and certain assets related to our transceiver business and multi-channel optical sub-assembly products (collectively, the "Divestiture"). The purchase price will be an amount equal to the \$150 million USD equivalent of Renminbi, less a holdback amount. Prior to the closing of the transaction we anticipate investing an amount equal to between 4% and 10% of the estimated proceeds from the transaction in exchange for a 10% equity interest in the Purchaser. The remaining funds from this transaction will significantly enhance our liquidity.

In the event we need additional liquidity, we will explore additional sources of liquidity. These additional sources of liquidity could include one, or a combination, of the following: (i) issuing equity or debt securities, (ii) incurring indebtedness secured by our assets and (iii) selling product lines, other assets and/or portions of our business. There can be no guarantee that we will be able to raise additional funds on terms acceptable to us, or at all.

Contractual Obligations and Commitments

Please refer to Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2022 for a complete discussion of its contractual obligations and commitments.

Inflation

The annual inflation rate in 2022 slowed down to 2.95% in Taiwan, which should remain the same in 2023 and was 6.5% in the US. Estimated inflation rate in the US is expected to continue to decline in 2023 based on U.S. Federal monetary policy "tapering" to address inflation.

Cost inflation included increases in shipping costs, labor rates, and in costs of some raw materials. We currently believe these increases are related to the COVID-19 pandemic (see the section above on the COVID-19 pandemic for more details of these challenges), however we cannot be sure when or if prices will return to pre-pandemic levels.

There is no guarantee that we can increase selling prices or reduce costs to fully mitigate the effect of inflation on our costs, which may adversely impact our sales margins and profitability.

Compared to other major economies in the world, China has a low level of inflation or even in deflation, which has not had a significant impact on our sales or operating results.

Critical Accounting Policies and Estimates

In our Annual Report for the year ended December 31, 2022 and in the Notes to the Financial Statements herein, we identify our most critical accounting policies. In preparing the financial statements, we make assumptions, estimates and judgments that affect the amounts reported. We periodically

evaluate our estimates and judgments that are most critical in nature which are related to revenue recognition, allowance for credit losses, inventory reserves, impairment of long-lived assets, service and product warranties, share based compensation expense, estimated useful lives of property and equipment, and income taxes. Our estimates are based on historical experience and on our future expectations that we believe are reasonable. The combination of these factors forms the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results are likely to differ from our current estimates and those differences may be material.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

For quantitative and qualitative disclosures about market risk affecting the Company, see Item 7A – Quantitative and Qualitative Disclosures about Market Risk in our Annual Report for the fiscal year ended December 31, 2022. We do not believe the Company's exposure to market risk has changed materially since December 31, 2022.

Item 4. Controls and Procedures

The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their control objectives.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2023. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three month period covered by this Quarterly Report on Form 10-Q, which were identified in connection with management's evaluation required by the Rules 13a-15(d) and 15d-15(d) under the Exchange Act that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

Information with respect to legal proceedings can be found in Note 18 to the Condensed Consolidated Financial Statements contained in Part 1, Item 1 of this report.

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. See Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2022 for a detailed discussion of the risk factors affecting our Company. As of March 31, 2023, there have been no material changes to those risk factors, except as described below.

The announcement and pendency of our proposed sale of our China manufacturing facilities could materially adversely affect our business, financial condition, and results of operations.

On September 15, 2022, AOI and Prime World International Holdings Ltd. (the "Seller"), which is a company incorporated in the British Virgin Islands and wholly owned subsidiary of AOI, entered into a definitive agreement (the "Purchase Agreement") with Yuhan Optoelectronic Technology (Shanghai) Co., Ltd. (the "Purchaser"), which is a company incorporated in the PRC, under which AOI would divest its manufacturing facilities located in the PRC and certain assets related to its transceiver business and multichannel optical sub-assembly products for the internet data center, FTTH and telecom markets. The purchase price payable by the Purchaser to the Seller will be an amount equal to the \$150 million USD equivalent of Renminbi, less a holdback amount. Prior to the closing of this transaction, AOI anticipates investing an amount equal to between 4% and 10% of the estimated proceeds from the transaction in exchange for a 10% equity interest in the Purchaser. This transaction is expected to close in late 2023 or 2024, subject to customary closing conditions and regulatory approval.

The announcement and pendency of our proposed divestiture could disrupt our business and create uncertainty about our future, which could have a material and negative impact on our business, financial condition, and results of operations, regardless of whether the divestiture is completed. These risks to our business, all of which could be exacerbated by any delay in the closing of the divestiture, include:

- restrictions in the Purchase Agreement on the conduct of our business prior to the closing of the divestiture, which prevent us from taking specified actions without the prior consent of Purchaser, which actions we might otherwise take in the absence of the Purchase Agreement.
- the attention of our management may be directed towards the closing of the divestiture and may be diverted from our day-to-day business operations, and matters related to the divestiture may require commitments of time and resources that could otherwise have been devoted to other opportunities that might have been beneficial to us;
- our customers, suppliers and other third parties may decide not to renew or seek to terminate, change or renegotiate their relationships with us, whether pursuant to the terms of their existing agreements with us or otherwise;
- our employees may experience uncertainty regarding their future roles, which might adversely affect our ability to retain, recruit and motivate key personnel; and
- potential litigation relating to the divestiture and the related costs.

Any of these matters could adversely affect our stock price, business, financial condition, results of operations, or business prospects. In addition, divestiture of our manufacturing facilities in the PRC also contains inherent risks that may impact our ability to fully realize the benefits of such divestiture, including possible delays in closing and potential post-closing claims for indemnification. The divestiture may also have a dilutive impact on our future earnings if we are unable to offset the dilutive impact from the loss of revenue associated with the divestiture, as well as significant write-offs, including those related to goodwill and other intangible assets. If any of these risks materialize, the benefits of such divestiture may not be fully realized, if at all, and our business, financial condition, and results of operations could be negatively impacted.

Item 6. Exhibits

See Exhibit Index.

EXHIBIT INDEX

Number	Description
2.1*	Agreement for the Sale and Purchase of a New Company to Be Established in Hong Kong Special Administrative Region of The People's Republic of China, dated as of September 15, 2022, by and between Prime World International Holdings Ltd., Applied Optoelectronics, Inc. and Yuhan Optoelectronic Technology (Shanghai) Co., Ltd. (filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 15, 2022).
3.1*	Amended and Restated Certificate of Incorporation, as currently in effect (filed as Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 14, 2013).
3.2*	Amended and Restated Bylaws, as currently in effect (filed as Exhibit 3.2 to the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 14, 2013).
4.1*	Common Stock Specimen (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 15, 2015).
4.2*	Indenture, dated as of March 5, 2019 between Applied Optoelectronics, Inc. and Wells Fargo Bank, National Association, as trustee, paying agent, and conversion agent (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2019).
4.3*	Form of Note representing the Company's 5.00% Convertible Senior Notes due 2024 (included as Exhibit A to the Indenture filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2019).
31.1**	Certification of Chief Executive Officer pursuant to Exchange Act Rule, 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2**	Certification of Chief Financial Officer pursuant to Exchange Act Rule, 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification pursuant to 18 U.S.C. 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer and Chief Financial Officer.
101.INS**	Inline XBRL Instance – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH**	Inline XBRL Taxonomy Extension Schema Document.
101.CAL**	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF**	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB**	Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE**	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104**	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

* Incorporated herein by reference to the indicated filing.

** Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLIED OPTOELECTRONICS, INC.

Date: May 4, 2023

By: /s/ STEFAN J. MURRY

STEFAN J. MURRY

Chief Financial Officer

(principal financial officer and principal accounting officer)

Certification

I, Chih-Hsiang (Thompson) Lin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Applied Optoelectronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of , and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2023

/s/ CHIH-HSIANG (THOMPSON) LIN
CHIH-HSIANG (THOMPSON) LIN
President and Chief Executive Officer

Certification

I, Stefan J. Murry, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Applied Optoelectronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of , and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2023

/s/ STEFAN J. MURRY

STEFAN J. MURRY

Chief Financial Officer

Certification

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and Section 1350 of Chapter 63 of Title 18 of the U.S. Code (18 U.S.C. § 1350), Chih-Hsiang (Thompson) Lin, President and Chief Executive Officer of Applied Optoelectronics, Inc. (the “Company”), and Stefan J. Murry, Chief Financial Officer and Senior Vice President of the Company, each hereby certifies that, to the best of his knowledge:

1. The Company’s Quarterly Report on Form 10-Q for the period ended March 31, 2023, to which this Certification is attached as Exhibit 32.1 (the “Quarterly Report”) fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act; and
2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

In Witness Whereof, the undersigned have set their hands hereto as of the 4th day of May 2023.

/s/ CHIH-HSIANG (THOMPSON) LIN

CHIH-HSIANG (THOMPSON) LIN

President and Chief Executive Officer

/s/ STEFAN J. MURRY

STEFAN J. MURRY

Chief Financial Officer

This certification accompanies the Quarterly Report to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Applied Optoelectronics, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Quarterly Report), irrespective of any general incorporation language contained in such filing.