AEHR TEST SYSTEMS
Form 10-Q
April 12, 2018

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

FORM 10-Q

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

For the quarterly period ended February 28, 2018

OR

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

For the transition period from _____ to _____

Commission file number: 000-22893

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

California (State or other jurisdiction of incorporation or organization)	94-2424084 (I.R.S. Employer Identification No.)
400 Kato Terrace Fremont, CA (Address of principal executive offices)	94539 (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period as the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files).

Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Number of shares of the registrant’s common stock, $0.01 par value, outstanding as of March 30, 2018 was 21,953,730.

AEHR TEST SYSTEMS

FORM 10-Q

FOR THE QUARTER ENDED FEBRUARY 28, 2018

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS (Unaudited)

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

	February 28, 2018	May 31, 2017
ASSETS		(1)
Current assets:		
Cash and cash equivalents	$9,077	$17,803
Short-term investments	5,986	--
Accounts receivable, net	4,673	4,010
Inventories	9,368	6,604
Prepaid expenses and other current assets	1,339	961
Total current assets	30,443	29,378
Property and equipment, net	1,205	1,419
Other assets	324	95
Total assets	$31,972	$30,892
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,638	$2,808
Accrued expenses	1,643	1,609
Customer deposits and deferred revenue, short-term	2,310	3,467
Total current liabilities	6,591	7,884
Long-term debt	6,110	6,110
Deferred revenue, long-term	497	104
Total liabilities	13,198	14,098
Aehr Test Systems shareholders' equity:		
Common stock, $0.01 par value:		

Authorized: 75,000 shares; Issued and outstanding: 21,943 shares and 21,340 shares at February 28, 2018 and May 31, 2017, respectively	219	213
Additional paid-in capital	82,671	81,128
Accumulated other comprehensive income	2,344	2,249
Accumulated deficit	(66,440)	(66,777)
Total Aehr Test Systems shareholders' equity	18,794	16,813
Noncontrolling interest	(20)	(19)
Total shareholders' equity	18,774	16,794
Total liabilities and shareholders' equity	$31,972	$30,892

(1)
The condensed consolidated balance sheet at May 31, 2017 has been derived from the audited consolidated financial statements at that date.

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

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

	Three Months Ended		Nine Months Ended	
	February 28,		February 28,	
	2018	2017	2018	2017
Net sales	$7,393	$2,681	$22,286	$12,215
Cost of sales	4,217	2,178	13,061	8,043
Gross profit	3,176	503	9,225	4,172
Operating expenses:				
Selling, general and administrative	1,829	1,724	5,474	5,147
Research and development	1,040	1,248	3,085	3,348
Total operating expenses	2,869	2,972	8,559	8,495
Income (loss) from operations	307	(2,469)	666	(4,323)
Interest expense, net	(98)	(178)	(310)	(537)
Other (expense) income, net	(33)	(2)	(100)	38
Income (loss) before income tax benefit (expense)	176	(2,649)	256	(4,822)
Income tax benefit (expense)	91	(2)	81	(36)
Net income (loss)	267	(2,651)	337	(4,858)
Less: Net income attributable to the noncontrolling interest	--	--	--	--
Net income (loss) attributable to Aehr Test Systems common shareholders	$267	$(2,651)	$337	$(4,858)
Net income (loss) per share				
Basic	$0.01	$(0.16)	$0.02	$(0.32)
Diluted	$0.01	$(0.16)	$0.01	$(0.32)
Shares used in per share calculations:				
Basic	21,832	16,672	21,631	15,411
Diluted	22,641	16,672	22,838	15,411

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

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

	Three Months Ended		Nine Months Ended	
	February 28,		February 28,	
	2018	2017	2018	2017
Net income (loss)	$267	$(2,651)	$337	$(4,858)
Other comprehensive income (loss), net of tax:				
Net change in unrealized loss on investments	--	--	(3)	--
Net change in cumulative translation adjustments	37	2	97	(46)
Total comprehensive income (loss)	304	(2,649)	431	(4,904)
Less: Comprehensive (loss) income attributable to the noncontrolling interest	(1)	--	(1)	1
Comprehensive income (loss), attributable to Aehr Test Systems common shareholders	$305	$(2,649)	$432	$(4,905)

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

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

	Nine Months Ended February 28,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$337	$(4,858)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Stock-based compensation expense	822	791
(Recovery of) provision for doubtful accounts	(3)	16
Amortization of debt issuance costs	--	133
Depreciation and amortization	300	195
Accretion of investment discount	(24)	--
Changes in operating assets and liabilities:		
Accounts receivable	(527)	(1,119)
Inventories	(2,392)	197
Prepaid expenses and other current assets	(603)	(100)
Accounts payable	(268)	726
Accrued expenses	31	325
Customer deposits and deferred revenue	(764)	(797)
Income taxes payable	(5)	23
Net cash used in operating activities	(3,096)	(4,468)
Cash flows from investing activities:		
Purchases of investments	(5,965)	--
Purchases of property and equipment	(458)	(219)
Net cash used in investing activities	(6,423)	(219)
Cash flows from financing activities:		
Proceeds from issuance of common stock under private placement, net of issuance costs	--	5,299
Proceeds from issuance of common stock under employee plans, net of taxes paid related to share settlement of equity awards	727	510
Net cash provided by financing activities	727	5,809
Effect of exchange rates on cash and cash equivalents	66	(22)

Net (decrease) increase in cash and cash equivalents	(8,726)	1,100
Cash and cash equivalents, beginning of period	17,803	939
Cash and cash equivalents, end of period	$9,077	$2,039

Supplemental disclosure of non-cash flow information:

Fair value of common stock issued to settle accounts payable	$--	$323
Transfer of property and equipment to inventories	$372	$372

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

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

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCCOUNTING POLICIES

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

In the opinion of management, the unaudited condensed consolidated financial statements for the interim periods presented have been prepared on a basis consistent with the May 31, 2017 audited consolidated financial statements and reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the condensed consolidated financial position and results of operations as of and for such periods indicated. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2017. Results for the interim periods presented herein are not necessarily indicative of results which may be reported for any other interim period or for the entire fiscal year.

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

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

REVENUE RECOGNITION. The Company recognizes revenue upon the shipment of products or the performance of services when: (1) persuasive evidence of the arrangement exists; (2) goods or services have been delivered; (3) the price is fixed or determinable; and (4) collectibility is reasonably assured. When a sales agreement involves multiple deliverables, such as extended support provisions, training to be supplied after delivery of the systems, and test programs specific to customers’ routine applications, the multiple deliverables are evaluated to determine the unit of accounting. Judgment is required to properly identify the accounting units of multiple element transactions and the manner in which revenue is allocated among the accounting units. Judgments made, or changes to judgments made, may significantly affect the timing or amount of revenue recognition.

Revenue related to the multiple elements is allocated to each unit of accounting using the relative selling price hierarchy. Consistent with accounting guidance, the selling price is based upon vendor specific objective evidence (VSOE). If VSOE is not available, third party evidence (TPE) is used to establish the selling price. In the absence of VSOE or TPE, estimated selling price is used.

During the first quarter of fiscal 2013, the Company entered into an agreement with a customer to develop a next generation system, and the Company shipped the first system in July 2016. The project identifies multiple milestones with values assigned to each. The consideration earned upon achieving the milestone is required to meet the following conditions prior to recognition: (i) the value is commensurate with the vendor's performance to meet the milestone, (ii) it relates solely to past performance, (iii) and it is reasonable relative to all of the deliverables and payment terms within the arrangement. Revenue is recognized for the milestone upon acceptance by the customer.

The Company recognizes revenue in certain circumstances before physical delivery has occurred. In these arrangements, among other things, risk of ownership has passed to the customer, the customer has made a written fixed commitment to purchase the products, the customer has requested the products be held for future delivery as scheduled and designated by them, and no additional performance obligations exist by the Company. For these transactions, the products are segregated from inventory and normal billing and credit terms granted.

Sales tax collected from customers is not included in net sales but rather recorded as a liability due to the respective taxing authorities. Provisions for the estimated future cost of warranty and installation are recorded at the time the products are shipped.

Royalty-based revenue related to licensing income from performance test boards and burn-in boards is recognized upon the earlier of the receipt by the Company of the licensee's report related to its usage of the licensed intellectual property or upon payment by the licensee.

The Company's terms of sales with distributors are generally FOB shipping point with payment due within 60 days. All products go through in-house testing and verification of specifications before shipment. Apart from warranty reserves, credits issued have not been material as a percentage of net sales. The Company's distributors do not generally carry inventories of the Company's products. Instead, the distributors place orders with the Company at or about the time they receive orders from their customers. The Company's shipment terms to our distributors do not provide for credits or rights of return. Because the Company's distributors do not generally carry inventories of our products, they do not have rights to price protection or to return products. At the time the Company ships products to the distributors, the price is fixed. Subsequent to the issuance of the invoice, there are no discounts or special terms. The Company does not give the buyer the right to return the product or to receive future price concessions. The Company's arrangements do not include vendor consideration.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES. The Company's significant accounting policies are disclosed in the Company's Annual Report on Form 10-K for the year ended May 31, 2017. There have been no significant changes in our significant accounting policies during the nine months ended February 28, 2018.

2. STOCK-BASED COMPENSATION

Stock-based compensation expense consists of expenses for stock options, restricted stock units, or RSUs, and employee stock purchase plan, or ESPP, purchase rights. Stock-based compensation cost for stock options and ESPP purchase rights are measured at each grant date, based on the fair value of the award using the Black-Scholes option valuation model, and is recognized as expense over the employee's requisite service period. This model was developed for use in estimating the value of publicly traded options that have no vesting restrictions and are fully transferable. The Company's employee stock options have characteristics significantly different from those of publicly traded options. For RSUs, stock-based compensation cost is based on the fair value of the Company's common stock at the grant date. All of the Company's stock-based compensation is accounted for as equity instruments. See Notes 11 and 12 in the Company's Annual Report on Form 10-K for fiscal 2017 filed on August 29, 2017 for further information regarding the 2016 Equity Incentive Plan and the Amended and Restated 2006 Employee Stock Purchase Plan.

The following table summarizes the stock-based compensation expense for the three and nine months ended February 28, 2018 and 2017 (in thousands):

	Three Months Ended		Nine Months Ended	
	February 28,		February 28,	
	2018	2017	2018	2017
Stock-based compensation in the form of employee stock options, RSUs and ESPP purchase rights, included in:				
Cost of sales	$28	$22	$107	$69
Selling, general and administrative	162	187	530	575
Research and development	52	48	185	147
Total stock-based compensation	$242	$257	$822	$791

As of February 28, 2018 and 2017, there were no stock-based compensation costs capitalized as part of inventory.

During the three months ended February 28, 2018 and 2017, the Company recorded stock-based compensation related to stock options and RSUs of $206,000 and $232,000, respectively. During the nine months ended February 28, 2018 and 2017, the Company recorded stock-based compensation related to stock options and RSUs of $614,000 and $695,000, respectively.

As of February 28, 2018, the total compensation cost related to unvested stock-based awards under the Company's 2016 Equity Incentive Plan, but not yet recognized, was approximately $1,120,000, which is net of estimated forfeitures of $3,000. This cost will be amortized on a straight-line basis over a weighted average period of approximately 2.4 years.

During the three months ended February 28, 2018 and 2017, the Company recorded stock-based compensation related to the ESPP of $36,000 and $25,000, respectively. During the nine months ended February 28, 2018 and 2017, the Company recorded stock-based compensation related to the ESPP of $208,000 and $96,000, respectively. The

increase in the three and nine months ended February 28, 2018 is primarily due to employees increasing their ESPP elections during the current fiscal year.

As of February 28, 2018, the total compensation cost related to purchase rights under the ESPP but not yet recognized was approximately $13,000. This cost will be amortized on a straight-line basis over a weighted average period of approximately 0.1 years.

Valuation Assumptions

Valuation and Amortization Method. The Company estimates the fair value of stock options granted using the Black-Scholes option valuation model and a single option award approach. The fair value under the single option approach is amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

Expected Term. The Company's expected term represents the period that the Company's stock-based awards are expected to be outstanding and was determined based on historical experience, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as evidenced by changes to the terms of its stock-based awards.

Volatility. Volatility is a measure of the amounts by which a financial variable such as stock price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company uses the historical volatility for the past four or five years, which matches the expected term of most of the option grants, to estimate expected volatility. Volatility for each of the ESPP's four time periods of six months, twelve months, eighteen months, and twenty-four months is calculated separately and included in the overall stock-based compensation cost recorded.

Risk-Free Interest Rate. The Company bases the risk-free interest rate used in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with a remaining term equivalent to the expected term of the stock awards including the ESPP.

Fair Value. The fair value of the Company's stock options granted to employees for the three months ended February 28, 2018 and nine months ended February 28, 2018 and 2017 were estimated using the following weighted average assumptions in the Black-Scholes option valuation model:

	Three Months Ended	Nine Months Ended	
	February 28,	February 28,	
	2018	2018	2017
Expected term (in years)	4	4	4
Volatility	0.73	0.77	0.81
Risk-free interest rates	2.31%	1.81%	1.02%
Weighted average grant date fair value	$1.53	$2.17	$1.09

There were no stock options granted to employees for the three months ended February 28, 2017.

There were no ESPP purchase rights granted during the three and nine months ended February 28, 2018 and 2017. Total ESPP shares issued during the nine months ended February 28, 2018 and 2017 were 116,000 and 65,000 shares, respectively. As of February 28, 2018, there were 265,000 ESPP shares available for issuance.

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The following table summarizes the Company's stock option and RSU transactions during the three and nine months ended February 28, 2018 (in thousands):

	Available Shares
Balance, May 31, 2017	2,169
Options granted	(224)
RSUs granted	(64)
Balance, August 31, 2017	1,881
Options granted	(41)
Balance, November 30, 2017	1,840
Options granted	(19)
RSUs granted	--
Shares cancelled	13
Plan shares expired	(2)
Balance, February 28, 2018	1,832

The following table summarizes the stock option transactions during the three and nine months ended February 28, 2018 (in thousands, except per share data):

	Outstanding Options		
	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balances, May 31, 2017	3,074	$1.73	$8,763
Options granted	224	$3.93	
Options exercised	(189)	$1.23	
Balances, August 31, 2017	3,109	$1.92	$4,612
Options granted	41	$3.46	
Options exercised	(132)	$1.46	
Balances, November 30, 2017	3,018	$1.96	$2,230
Options granted	19	$2.76	
Options cancelled	(13)	$2.71	
Options exercised	(141)	$0.89	
Balances, February 28, 2018	2,883	$2.01	$1,486
Options fully vested and expected to vest at February 28, 2018	2,849	$2.01	$1,480

The options outstanding and exercisable at February 28, 2018 were in the following exercise price ranges (in thousands, except per share data):

	Options Outstanding at February 28, 2018			Options Exercisable at February 28, 2018			
Range of Exercise	Number Outstanding	Weighted Average	Weighted Average	Number Exercisable	Weighted Average	Weighted Average	Aggregate Intrinsic

Prices	Shares	Remaining Contractual Life (Years)	Exercise Price	Shares	Remaining Contractual Life (Years)	Exercise Price	Value
$0.59-$0.97	324	1.02	$0.66	324	1.02	$0.66	
$1.09-$1.36	605	1.88	$1.28	605	1.88	$1.28	
$1.68-$2.06	486	4.48	$1.74	295	3.89	$1.79	
$2.10-$2.81	1,204	3.79	$2.45	1,012	3.74	$2.47	
$3.46-$3.93	264	6.41	$3.86	46	6.45	$3.79	
$0.59-$3.93	2,883	3.43	$2.01	2,282	2.93	$1.83	$1,351

The total intrinsic value of options exercised during the three and nine months ended February 28, 2018 was $214,000 and $959,000, respectively. The total intrinsic value of options exercised during the three and nine months ended February 28, 2017 was $154,000 and $564,000, respectively. The weighted average remaining contractual life of the options exercisable and expected to be exercisable at February 28, 2018 was 3.42 years.

There were no RSUs granted to employees for the three months ended February 28, 2018 or 2017. During the nine months ended February 28, 2018, RSUs for 64,000 shares were granted. The market value on the date of the grant of these RSUs was $3.93 per share. During the nine months ended February 28, 2017, RSUs for 157,000 shares were granted. The market value on the date of the grant of these RSUs was $1.78 per share. 4,000 and 11,000 RSUs became fully vested during the three and nine months ended February 28, 2018, respectively. 85,000 RSUs were unvested at February 28, 2018. The intrinsic value of the unvested RSUs at February 28, 2018 was $194,000.

3. EARNINGS PER SHARE

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

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

	Three Months Ended		Nine Months Ended	
	February 28,		February 28,	
	2018	2017	2018	2017
Numerator: Net income (loss)	$267	$(2,651)	$337	$(4,858)
Denominator for basic net income (loss) per share:				
Weighted-average shares outstanding	21,832	16,672	21,631	15,411
Shares used in basic net income (loss) per share calculation	21,832	16,672	21,631	15,411
Effect of dilutive securities	809	--	1,207	--
Denominator for diluted net income (loss) per share	22,641	16,672	22,838	15,411
Basic net income (loss) per share	$0.01	$(0.16)	$0.02	$(0.32)
Diluted net income (loss) per share	$0.01	$(0.16)	$0.01	$(0.32)

For the purpose of computing diluted earnings per share, the weighted average number of potential common shares does not include stock options with an exercise price greater than the average fair value of the Company's common stock for the period, as the effect would be anti-dilutive. Stock options to purchase 983,000 shares of common stock were outstanding as of February 28, 2018 but were not included in the computation of diluted net income per share, because the inclusion of such shares would be anti-dilutive. In the three and nine months ended February 28, 2017, potential common shares have not been included in the calculation of diluted net loss per share as the effect would be anti-dilutive. As such, the numerator and the denominator used in computing both basic and diluted net loss per share for this period are the same. Stock options to purchase 3,157,000 shares of common stock, RSUs for 34,000 shares and ESPP rights to purchase 253,000 ESPP shares were outstanding as of February 28, 2017 but were not included in

the computation of diluted net loss per share, because the inclusion of such shares would be anti-dilutive. The 2,657,000 shares convertible under the convertible notes outstanding at February 28, 2018 and 2017 were not included in the computation of diluted net income (loss) per share, because the inclusion of such shares would be anti-dilutive.

4. CASH, CASH EQUIVALENTS AND INVESTMENTS

The following table summarizes the Company's cash, cash equivalents and investments by security type at February 28, 2018 (in thousands):

	Cost	Gross Unrealized Loss	Estimated Fair Value
Cash	$1,899	$--	$1,899
Cash equivalents:			
Money market funds	7,178	--	7,178
U.S. Treasury securities	--	--	--
Total Cash equivalents	7,178	--	7,178
Total Cash and Cash equivalents	$9,077	$--	$9,077
Short-term investments:			
U.S. Treasury securities	$5,989	$3	$5,986
Long-term investments:			
Certificate of deposit	$80	--	$80
Total Cash, Cash equivalents and Investments	$15,146	$3	$15,143

Long-term investments are included in other assets on the accompanying condensed consolidated balance sheets.

Unrealized gains and temporary losses on investments classified as available-for-sale are included within accumulated other comprehensive income ("AOCI"), net of any related tax effect. Upon realization, those amounts are reclassified from AOCI to results of operations.

The unrealized loss as of February 28, 2018 is not considered other-than-temporary, and has been in an unrealized loss position for less than a year.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments are measured at fair value consistent with authoritative guidance. This authoritative guidance defines fair value, establishes a framework for using fair value to measure assets and liabilities, and disclosures required related to fair value measurements.

The guidance establishes a fair value hierarchy based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The fair value hierarchy consists of the following three levels:

Level 1 - instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets.

Level 2 - instrument valuations are obtained from readily-available pricing sources for comparable instruments.

Level 3 - instrument valuations are obtained without observable market values and require a high level of judgment to determine the fair value.

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The following table summarizes the Company's financial assets measured at fair value on a recurring basis as of February 28, 2018 (in thousands):

	Balance as of			
	February 28, 2018	Level 1	Level 2	Level 3
Money market funds	$7,178	$7,178	$--	$--
U.S. Treasury securities	5,986	5,986	--	--
Certificate of deposit	80	--	80	--
Assets	$13,244	$13,164	$80	$--

The U.S. Treasury Securities have maturities of six months.

The following table summarizes the Company's financial assets measured at fair value on a recurring basis as of May 31, 2017 (in thousands):

	Balance as of			
	May 31, 2017	Level 1	Level 2	Level 3
Money market funds	$15,516	$15,516	$--	$--
Certificate of deposit	50	--	50	--
Assets	$15,566	$15,516	$50	$--

There were no financial liabilities measured at fair value as of February 28, 2018 and May 31, 2017.

There were no transfers between Level 1 and Level 2 fair value measurements during the three and nine months ended February 28, 2018.

The carrying amounts of financial instruments including cash, cash equivalents, receivables, accounts payable and certain other accrued liabilities, approximate fair value due to their short maturities. Based on the borrowing rates currently available to the Company for loans with similar terms, the carrying value of the debt approximates the fair value.

The Company has, at times, invested in debt and equity of private companies, and may do so again in the future, as part of its business strategy.

6. ACCOUNTS RECEIVABLE, NET

Accounts receivable represent customer trade receivables and is presented net of allowances for doubtful accounts of $58,000 at February 28, 2018 and $61,000 at May 31, 2017. Accounts receivable are derived from the sale of products throughout the world to semiconductor manufacturers, semiconductor contract assemblers, electronics manufacturers and burn-in and test service companies. The Company's allowance for doubtful accounts is based upon historical experience and review of trade receivables by aging category to identify specific customers with known disputes or

collection issues. Uncollectible receivables are recorded as bad debt expense when all efforts to collect have been exhausted and recoveries are recognized when they are received.

7. INVENTORIES

Inventories are comprised of the following (in thousands):

	February 28, 2018	May 31, 2017
Raw materials and sub-assemblies	$5,616	$4,268
Work in process	3,518	2,059
Finished goods	234	277
	$9,368	$6,604

8. SEGMENT INFORMATION

The Company operates in one reportable segment: the design, manufacture and marketing of advanced test and burn-in products to the semiconductor manufacturing industry.

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

	United States	Asia	Europe	Total
Three months ended February 28, 2018:				
Net sales	$1,493	$4,974	$926	$7,393
Property and equipment, net	1,155	41	9	1,205
Nine months ended February 28, 2018:				
Net sales	$4,747	$16,543	$996	$22,286
Property and equipment, net	1,155	41	9	1,205
Three months ended February 28, 2017:				
Net sales	$546	$2,017	$118	$2,681
Property and equipment, net	808	39	14	861
Nine months ended February 28, 2017:				
Net sales	$5,419	$6,183	$613	$12,215
Property and equipment, net	808	39	14	861

The Company's Japanese and German subsidiaries primarily comprise the foreign operations. Substantially all of the sales of the subsidiaries are made to unaffiliated Japanese or European customers. Net sales from outside the United

States include those of Aehr Test Systems Japan K.K. and Aehr Test Systems GmbH.

Sales to the Company's five largest customers accounted for approximately 93% and 93% of its net sales in the three and nine months ended February 28, 2018, respectively. Four customers accounted for approximately 31%, 25%, 16% and 12% of the Company's net sales in the three months ended February 28, 2018. Three customers accounted for approximately 35%, 34% and 13% of the Company's net sales in the nine months ended February 28, 2018. Sales to the Company's five largest customers accounted for approximately 98% and 95% of its net sales in the three and nine months ended February 28, 2017, respectively. One customer accounted for approximately 91% of the Company's net sales in the three months ended February 28, 2017. Three customers accounted for approximately 59%, 15% and 13% of the Company's net sales in the nine months ended February 28, 2017. No other customers represented more than 10% of the Company's net sales in the three and nine months ended February 28, 2018 and 2017.

9. PRODUCT WARRANTIES

The Company provides for the estimated cost of product warranties at the time revenues are recognized on the products shipped. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, the Company's warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from the Company's estimates, revisions to the estimated warranty liability would be required.

The standard warranty period is one year for systems and ninety days for parts and service.

The following is a summary of changes in the Company's liability for product warranties during the three and nine months ended February 28, 2018 and February 28, 2017 (in thousands):

	Three Months Ended		Nine Months Ended	
	February 28,		February 28,	
	2018	2017	2018	2017
Balance at the beginning of the period	$133	$72	$113	$155
Accruals for warranties issued during the period	5	37	251	48
Accruals and adjustments (change in estimates) related to pre-existing warranties during the period	--	--	--	(54)
Consumption of reserves	(22)	(23)	(248)	(63)
Balance at the end of the period	$116	$86	$116	$86

The accrued warranty balance is included in accrued expenses on the accompanying condensed consolidated balance sheets.

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10. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the components of AOCI, net of tax, were as follows (in thousands):

	Cumulative Translation Adjustments	Unrealized Loss on Investments, Net	Total
Balance at May 31, 2017	$2,249	$--	$2,249
Other comprehensive income (loss) before reclassifications	98	(3)	95
Amounts reclassified out of AOCI	--	--	--
Other comprehensive income (loss), net of tax	98	(3)	95
Balance at February 28, 2018	$2,347	$(3)	$2,344

11. INCOME TAXES

Income taxes have been provided using the liability method whereby deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and net operating loss and tax credit carryforwards measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse or the carryforwards are utilized. Valuation allowances are established when it is determined that it is more likely than not that such assets will not be realized.

Since fiscal 2009, a full valuation allowance was established against all deferred tax assets as management determined that it is more likely than not that certain deferred tax assets will not be realized.

The Company accounts for uncertain tax positions consistent with authoritative guidance. The guidance prescribes a “more likely than not” recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company does not expect any material change in its unrecognized tax benefits over the next twelve months. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income taxes.

Although the Company files U.S. federal, various state, and foreign tax returns, the Company’s only major tax jurisdictions are the United States, California, Germany and Japan. Tax years 1997 - 2017 remain subject to examination by the appropriate governmental agencies due to tax loss carryovers from those years.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740, Income taxes. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company’s accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements.

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As part of the transition to the new territorial tax system, the Tax Act imposes a one-time repatriation tax on deemed repatriation of historical earnings of foreign subsidiaries. The company is not subject to the transition tax. The one-time transition tax is based on post-1986 earnings and profits that were previously deferred from U.S. income tax. While the Company has not yet finalized its calculation of the total post-1986 earnings and profits for its foreign corporations or the impact of foreign tax credits, it has prepared a reasonable estimate and calculation of nil transition tax. The Company is continuing to evaluate the calculation and accounting of the transition tax, which may change as the Company's interpretation of the provisions of the Tax Act evolve, additional information becomes available or interpretive guidance is issued by the U.S. Treasury. The final determination will be completed no later than one year from the enactment date. Based on current year and carryover losses and valuation allowance, the Company does not expect an impact to its consolidated financial statements upon completion of the analysis.

The new law also repeals the corporate alternative minimum tax, or AMT, effective December 31, 2017. The law repeals the corporate alternative minimum tax regime and permits existing minimum tax credits to offset the regular tax liability for any tax year. Further, the credit is refundable for any tax year beginning after December 31, 2017 and before December 31, 2020 in an amount equal to 50% of the excess of the minimum tax credit over the allowable credit for the year against the regular tax liability. Any unused minimum tax credit carryforward is refundable in the following year. As result, the company recorded a benefit of $90,000 for its Federal refundable AMT credit.

In addition, the reduction of U.S. federal corporate tax rate reduces the corporate tax rate to 21%, effective January 1, 2018. Consequently, the Company has accounted for the reduction of $6.2 million of deferred tax assets with an offsetting adjustment to the valuation allowance.

12. CUSTOMER DEPOSITS AND DEFERRED REVENUE, SHORT-TERM

Customer deposits and deferred revenue, short-term (in thousands):

	February 28, 2018	May 31, 2017
Customer deposits	$2,049	$3,264
Deferred revenue	261	203
	$2,310	$3,467

13. LONG-TERM DEBT

On April 10, 2015, the Company entered into a Convertible Note Purchase and Credit Facility Agreement (the “Purchase Agreement”) with QVT Fund LP and Quintessence Fund L.P. (the “Purchasers”) providing for (a) the Company’s sale to the Purchasers of $4,110,000 in aggregate principal amount of 9.0% Convertible Secured Notes due 2017 (the “Convertible Notes”) and (b) a secured revolving loan facility (the “Credit Facility”) in an aggregate principal amount of up to $2,000,000. On August 22, 2016 the Purchase Agreement was amended to extend the maturity date of the Convertible Notes to April 10, 2019, decrease the conversion price from $2.65 per share to $2.30 per share, decrease the forced conversion price from $7.50 per share to $6.51 per share, and allow for additional equity awards.

The Convertible Notes bear interest at an annual rate of 9.0% and will mature on April 10, 2019 unless repurchased or converted prior to that date. Interest is payable quarterly on March 1, June 1, September 1 and December 1 of each year. Debt issuance costs of $356,000, which were accreted over the term of the original loan using the effective interest rate method, were offset against the loan balance.

The conversion price for the Convertible Notes is $2.30 per share and is subject to adjustment upon the occurrence of certain specified events. Holders may convert all or any part of the principal amount of their Convertible Notes in integrals of $10,000 at any time prior to the maturity date. Upon conversion, the Company will deliver shares of its common stock to the holder of Convertible Notes electing such conversion. The Company may not redeem the Convertible Notes prior to maturity.

The maximum amount of $2,000,000 drawn against the Credit Facility has been converted to Convertible Notes, and at February 28, 2018 there was no remaining balance available to be drawn on the Credit Facility.

The Company's obligations under the Purchase Agreement are secured by substantially all of the assets of the Company.

14. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Adopted

Inventory Measurement

In July 2015, the Financial Accounting Standards Board ("FASB") issued an accounting standard update that requires management to measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The Company adopted this new standard in fiscal year 2018. The adoption of this guidance did not have a significant impact on the Company's consolidated financial statements.

Balance Sheet Classification of Deferred Taxes

In November 2015, the FASB issued an accounting standard update related to deferred tax assets and liabilities. This standard simplifies the presentation of deferred income taxes to be classified as noncurrent in the consolidated balance sheet. The Company adopted this new standard in fiscal year 2018. The adoption of this guidance did not have a significant impact on the Company's consolidated financial statements.

Share-Based Compensation

In March 2016, the FASB released an accounting standard update that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, forfeitures, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The Company adopted this new standard in fiscal year 2018. The adoption of this guidance did not have a significant impact on the Company's consolidated financial statements.

Accounting Standards Not Yet Adopted

Revenue Recognition

In May 2014, the FASB issued an accounting standard update related to revenue from contracts with customers. This standard sets forth a new five-step revenue recognition model which replaces the prior revenue recognition guidance in its entirety and is intended to eliminate numerous industry-specific pieces of revenue recognition guidance that have historically existed in GAAP. The underlying principle of the new standard is that a business or other organization will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. The standard also requires more detailed disclosures and provides additional guidance for transactions that were not addressed completely in the prior accounting guidance. The standard provides alternative methods of initial adoption and will become effective for the Company beginning in the first quarter of fiscal 2019. The FASB has issued several updates to the standard which i) defer the original effective date from January 1, 2017 to January 1, 2018, while allowing for early adoption as of January 1, 2017. ii) clarify the application of the principal versus agent guidance. and iii) clarify the guidance on inconsequential and perfunctory promises and licensing. In May 2016, the FASB issued an update to address certain narrow aspects of the guidance including collectibility criterion, collection of sales taxes from customers, noncash consideration, contract modifications and completed contracts. This issuance does not change the core principle of the guidance in the initial topic issued in May 2014. In December 2016, the FASB issued updated guidance regarding revenue from contracts with customers. Some topics that could impact the Company include corrections and improvements around the following: contract costs impairment testing, disclosure of remaining performance obligations and prior period obligations, contract modifications, and contract asset versus receivable. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

Financial Instruments

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

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

Leases

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

Classification of Certain Cash Receipts and Cash Payments
In August 2016, the FASB issued authoritative guidance related to the classification of certain cash receipts and cash payments on the statement of cash flows. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019 on a retrospective basis, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated statements of cash flows.

Intra-Entity Asset Transfers
In October 2016, the FASB issued an accounting standard update that requires recognition of the income tax consequences of intra-entity transfers of assets (other than inventory) at the transaction date. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019 on a modified retrospective basis, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

Restricted Cash
In November 2016, the FASB issued authoritative guidance related to statements of cash flows. This guidance clarifies that amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of period total amounts shown on the statement of cash flows. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019 on a retrospective basis, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes that appear elsewhere in this report and with our Annual Report on Form 10-K for the fiscal year ended May 31, 2017 and the consolidated financial statements and notes thereto.

In addition to historical information, this report contains 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. All statements in this report, including those made by the management of Aehr Test Systems, other than statements of historical fact, are forward-looking statements. These statements typically may be identified by the use of forward-looking words or phrases such as "believe," "expect," "intend," "anticipate," "should," "planned," "estimated," and "potential," among others and include, but are not limited to, statements concerning our expectations regarding our operations, business, strategies, prospects, revenues, expenses, costs and resources. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those anticipated results or other expectations reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report and other factors beyond our control, and in particular, the risks discussed in “Part II, Item 1A. Risk Factors” and those discussed in other documents we file with the SEC. All forward-looking statements included in this document are based on our current expectations, and we undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

OVERVIEW

We were founded in 1977 to develop and manufacture burn-in and test equipment for the semiconductor industry. Since our inception, we have sold more than 2,500 systems to semiconductor manufacturers, semiconductor contract assemblers and burn-in and test service companies worldwide. Our principal products currently are the Advanced Burn-in and Test System, or ABTSTM, the FOXTM full wafer contact and singulated die/module parallel test and burn-in system, WaferPakTM Aligner, WaferPak contactors, DiePak® Loader, the DiePak carrier and test fixtures.

Our net sales consist primarily of sales of systems, WaferPak Aligners and DiePak Loaders, WaferPak contactors, DiePak Carriers, test fixtures, upgrades and spare parts, revenues from service contracts, and engineering development charges. Our selling arrangements may include contractual customer acceptance provisions, which are mostly deemed perfunctory or inconsequential, and installation of the product occurs after shipment and transfer of title.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to customer programs and incentives, product returns, bad debts, inventories, income taxes, financing operations, warranty obligations, and long-term service contracts. Our estimates are derived from historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Those results form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. For a discussion of the critical accounting policies, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates” in our Annual Report on Form 10-K for the fiscal year ended May 31, 2017.

There have been no material changes to our critical accounting policies and estimates during the nine months ended February 28, 2018 compared to those discussed in our Annual Report on Form 10-K for the fiscal year ended May 31, 2017.

RESULTS OF OPERATIONS

The following table sets forth items in our unaudited condensed consolidated statements of operations as a percentage of net sales for the periods indicated.

	Three Months Ended		Nine Months Ended	
	February 28,		February 28,	
	2018	2017	2018	2017
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	57.0	81.2	58.6	65.8
Gross profit	43.0	18.8	41.4	34.2
Operating expenses:				
Selling, general and administrative	24.7	64.3	24.6	42.1
Research and development	14.1	46.6	13.8	27.5
Total operating expenses	38.8	110.9	38.4	69.6
Income (loss) from operations	4.2	(92.1)	3.0	(35.4)
Interest expense, net	(1.3)	(6.6)	(1.4)	(4.4)
Other (expense) income, net	(0.5)	(0.1)	(0.5)	0.3
Income (loss) before income tax benefit (expense)	2.4	(98.8)	1.1	(39.5)
Income tax benefit (expense)	1.2	(0.1)	0.4	(0.3)
Net income (loss)	3.6	(98.9)	1.5	(39.8)
Less: Net income attributable to the noncontrolling interest	--	--	--	--
Net income (loss) attributable to Aehr Test Systems common shareholders	3.6%	(98.9)%	1.5%	(39.8)%

THREE MONTHS ENDED FEBRUARY 28, 2018 COMPARED TO THREE MONTHS ENDED FEBRUARY 28, 2017

NET SALES. Net sales increased to $7.4 million for the three months ended February 28, 2018 from $2.7 million for the three months ended February 28, 2017, an increase of 175.8%. The increase in net sales for the three months ended February 28, 2018 was primarily due to the increases in both net sales of our Test During Burn-in (TDBI) products and wafer-level products. Net sales of the TDBI products for the three months ended February 28, 2018 were $4.5 million, and increased approximately $1.9 million from the three months ended February 28, 2017. Net sales of the wafer-level products for the three months ended February 28, 2018 were $2.9 million, and increased approximately $2.8 million from the three months ended February 28, 2017.

GROSS PROFIT. Gross profit increased to $3.2 million for the three months ended February 28, 2018 from $0.5 million for the three months ended February 28, 2017. Gross profit margin increased to 43.0% for the three months ended February 28, 2018 from 18.8% for the three months ended February 28, 2017. The increase in gross profit margin of 24.2% was primarily due to manufacturing efficiencies due to an increase in net sales resulting in a 14.0% gross profit margin increase, and a decreased warranty provision resulting in a 10.0% gross profit margin increase.

SELLING, GENERAL AND ADMINISTRATIVE. SG&A expenses increased to $1.8 million for the three months ended February 28, 2018 from $1.7 million for the three months ended February 28, 2017, an increase of 6.1%. The increase in SG&A expenses was primarily due to an increase in employment related expenses.

RESEARCH AND DEVELOPMENT. R&D expenses decreased to $1.0 million for the three months ended February 28, 2018 from $1.2 million for the three months ended February 28, 2017, a decrease of 16.7%. The decrease in R&D expenses was primarily due to a decrease in project expenses.

INTEREST EXPENSE. Interest expenses were $98,000 and $178,000 for the three months ended February 28, 2018 and 2017, respectively. The decrease in interest expense in the three months ended February 28, 2018 was primarily due to the debt issuance costs related to the convertible notes becoming fully amortized at the end of fiscal 2017.

OTHER (EXPENSE) INCOME, NET. Other expense, net was $33,000 and $2,000 for the three months ended February 28, 2018 and 2017, respectively. The change in other expense was primarily due to losses realized in connection with the fluctuation in the value of the dollar compared to foreign currencies during the referenced periods.

INCOME TAX BENEFIT (EXPENSE). Income tax benefit was $91,000 for the three months ended February 28, 2018 compared with income tax expense of $2,000 for the three months ended February 28, 2017. The income tax benefit in the three months ended February 28, 2018 was primarily due to the impact of the “Tax Cuts and Jobs Act” enacted on December 22, 2017, specifically, the provision which made our alternative minimum tax credit refundable by 2022.

NINE MONTHS ENDED FEBRUARY 28, 2018 COMPARED TO NINE MONTHS ENDED FEBRUARY 28, 2017

NET SALES. Net sales increased to $22.3 million for the nine months ended February 28, 2018 from $12.2 million for the nine months ended February 28, 2017, an increase of 82.4%. The increase in net sales for the nine months ended February 28, 2018 was primarily due to the increases in both net sales of our TDBI products and wafer-level products. Net sales of the TDBI products for the nine months ended February 28, 2018 were $12.4 million, and increased approximately $4.6 million from the nine months ended February 28, 2017. Net sales of the wafer-level products for the nine months ended February 28, 2018 were $9.9 million, and increased approximately $5.6 million from the nine months ended February 28, 2017.

GROSS PROFIT. Gross profit increased to $9.2 million for the nine months ended February 28, 2018 from $4.2 million for the nine months ended February 28, 2017, an increase of 121.1%. Gross profit margin increased to 41.4% for the nine months ended February 28, 2018 from 34.2% for the nine months ended February 28, 2017. The increase in gross profit margin was primarily due to manufacturing efficiencies due to an increase in net sales.

SELLING, GENERAL AND ADMINISTRATIVE. SG&A expenses increased to $5.5 million for the nine months ended February 28, 2018 from $5.1 million for the nine months ended February 28, 2017, an increase of 6.4%. The increase in SG&A expenses was primarily due to an increase in employment related expenses.

RESEARCH AND DEVELOPMENT. R&D expenses decreased to $3.1 million for the nine months ended February 28, 2018 from $3.3 million for the nine months ended February 28, 2017, a decrease of 7.9%. The decrease in R&D expenses was primarily due to a decrease of $0.4 million in project expenses, partially offset by an increase of $0.1 million in employment related expenses.

INTEREST EXPENSE. Interest expense was $310,000 for the nine months ended February 28, 2018 compared with $537,000 for the nine months ended February 28, 2017. The decrease in interest expense in the nine months ended February 28, 2018 was primarily due to the debt issuance costs related to the convertible notes becoming fully amortized at the end of fiscal 2017.

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OTHER (EXPENSE) INCOME, NET. Other expense, net was $100,000 for the nine months ended February 28, 2018 compared with other income, net of $38,000 for the nine months ended February 28, 2017. The change between other expense and other income was primarily due to losses or gains realized in connection with the fluctuation in the value of the dollar compared to foreign currencies during the referenced periods.

INCOME TAX BENEFIT (EXPENSE). Income tax benefit was $81,000 for the nine months ended February 28, 2018 compared with income tax expense of $36,000 for the nine months ended February 28, 2017. The income tax benefit in the nine months ended February 28, 2018 was primarily due to the impact of the “Tax Cuts and Jobs Act” enacted on December 22, 2017, specifically, the provision which made our alternative minimum tax credit refundable by 2022.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities was $3.1 million and $4.5 million for the nine months ended February 28, 2018 and 2017, respectively. For the nine months ended February 28, 2018, net cash used in operating activities was primarily the result of the changes in operating assets and liabilities including the increases in inventories, prepaid expenses and other current assets, and accounts receivable of $2.4 million, $0.6 million and $0.5 million, respectively, and a decrease of customer deposits and deferred revenue of $0.8 million. Net cash used in operating activities was also impacted by net income of $0.3 million, as adjusted to exclude the effect of non-cash charges of stock-based compensation expense of $0.8 million and depreciation and amortization of $0.3 million. The increase in inventories is to support expected future shipments for customer orders. The increase in prepaid expenses and other current assets was primarily due to down payments to certain vendors. The increase in accounts receivable was primarily due to large shipments toward the end of the quarter. The decrease in customer deposits and deferred revenue was primarily due to the shipments against customer orders with down payments. For the nine months ended February 28, 2017, net cash used in operating activities was primarily the result of net loss of $4.9 million, as adjusted to exclude the effect of non-cash charge of stock-based compensation expense of $0.8 million. Net cash used in operations was also impacted by an increase in accounts receivable of $1.1 million, partially offset by an increase in accounts payable of $0.7 million. The increase in accounts receivable was primarily due to large shipments toward the end of February 28, 2017. The increase in accounts payable was primarily due to inventory purchases to support future shipments.

Net cash used in investing activities was $6.4 million and $219,000 for the nine months ended February 28, 2018 and 2017, respectively. During the nine months ended February 28, 2018, net cash used in investing activities was due to the purchase of available for sale securities of $6.0 million, which did not affect our liquidity, and the purchases of property and equipment of $0.5 million. During the nine months ended February 28, 2017, net cash used in investing activities was due to the purchases of property and equipment.

Financing activities provided cash of $0.7 million and $5.8 million for the nine months ended February 28, 2018 and 2017, respectively. Net cash provided by financing activities during the nine months ended February 28, 2018 was due to $0.7 million in proceeds from the issuance of common stock under employee plans. Net cash provided by financing activities during the nine months ended February 28, 2017 was due to the net proceeds of $5.3 million from the sale of our common stock in a private placement transaction to certain institutional and accredited investors that closed on September 28, 2016 and $0.5 million in proceeds from the issuance of common stock under employee plans.

The effect of fluctuation in exchange rates increased cash by $66,000 for the nine months ended February 28, 2018 and decreased cash by $22,000 for the nine months ended February 28, 2017. The changes were due to the fluctuation in the value of the dollar compared to foreign currencies.

As of February 28, 2018 and May 31, 2017, we had working capital of $23.9 million and $21.5 million, respectively. Working capital consists of cash and cash equivalents, short-term investments, accounts receivable, inventories and prepaid expenses and other current assets, less current liabilities.

We lease our manufacturing and office space under operating leases. We entered into a non-cancelable operating lease agreement for our United States manufacturing and office facilities, which was renewed in February 2018 and expires in July 2023. Under the lease agreement, we are responsible for payments of utilities, taxes and insurance.

From time to time, we evaluate potential acquisitions of businesses, products or technologies that complement our business. If consummated, any such transactions may use a portion of our working capital or require the issuance of equity. We have no present understandings, commitments or agreements with respect to any material acquisitions.

We anticipate that the existing cash balance together with income from operations, collections of existing accounts receivable, revenue from our existing backlog of products, the sale of inventory on hand, and deposits and down payments against significant orders will be adequate to meet our liquidity requirements for the next 12 months.

OFF-BALANCE SHEET ARRANGEMENTS

We have not entered into any off-balance sheet financing arrangements and have not established any variable interest entities.

OVERVIEW OF CONTRACTUAL OBLIGATIONS

The only material changes in the composition, magnitude or other key characteristics of our contractual obligations or other commitments as disclosed in our Annual Report on Form 10-K for the year ended May 31, 2017 was the extension of the lease of our principal executive office entered into on February 27, 2018 and as disclosed on our Current Report on Form 8-K filed with the SEC on March 2, 2018.

Minimum annual rentals payments under non-cancellable operating leases in each of the next five fiscal years and thereafter are as follows (in thousands):

Years Ending May 31,	
2018	$502
2019	713
2020	728
2021	749
2022	772
Thereafter	861
Total	$4,325

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

We had no holdings of derivative financial or commodity instruments as of February 28, 2018 or May 31, 2017.

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We are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. We only invest our short-term excess cash in government-backed securities with maturities of 18 months or less. We do not use any financial instruments for speculative or trading purposes. Fluctuations in interest rates would not have a material effect on our financial position, results of operations or cash flows.

A majority of our revenue and capital spending is transacted in U.S. Dollars. We, however, enter into transactions in other currencies, primarily Euros and Japanese Yen. Since the price is determined at the time a purchase order is accepted, we are exposed to the risks of fluctuations in the foreign currency-U.S. Dollar exchange rates during the lengthy period from purchase order to ultimate payment. This exchange rate risk is partially offset to the extent that our subsidiaries incur expenses payable in their local currency. To date, we have not invested in instruments designed to hedge currency risks. In addition, our subsidiaries typically carry debt or other obligations due us that may be denominated in either their local currency or U.S. Dollars. Since our subsidiaries' financial statements are based in their local currency and our condensed consolidated financial statements are based in U.S. Dollars, we and our subsidiaries recognize foreign exchange gains or losses in any period in which the value of the local currency rises or falls in relation to the U.S. Dollar. A 10% decrease in the value of the subsidiaries' local currency as compared with the U.S. Dollar would not be expected to result in a significant change to our net income or loss. There have been no material changes in our risk exposure since the end of the last fiscal year, nor are any material changes to our risk exposure anticipated.

Item 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that such information is accumulated and communicated to management as appropriate to allow for timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING. There was no change in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

INHERENT LIMITATIONS OF INTERNAL CONTROLS. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within us have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the

inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

Item 1A. RISK FACTORS

Please refer to the description of the risk factors associated with our business previously disclosed in Part I, Item 1A - "Risk Factors" of our Annual Report on Form 10-K for the year ended May 31, 2017 filed with the Securities and Exchange Commission on August 29, 2017. There have been no material changes from the risk factors previously described under Item 1A of our Annual Report on Form 10-K for the fiscal year ended May 31, 2017.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. MINE SAFETY DISCLOSURES

Not Applicable

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Exhibit No.	Description
10.1(1)	Third Amendment dated February 27, 2018 for facilities located at 400 Kato Terrace, Fremont, California.
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference to Exhibit No. 3.1 previously filed with the Company's Current Report on Form 8-K filed March 2, 2018 (File No. 000-22893).

*This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, nor shall it be deemed incorporated by reference in any filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

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.

Aehr Test Systems
(Registrant)

Date: April 12, 2018 By: /s/ GAYN ERICKSON
Gayn Erickson
President and Chief Executive Officer

Date: April 12, 2018 By: /s/ KENNETH B. SPINK
Kenneth B. Spink
Vice President of Finance
and Chief Financial Officer