AEHR TEST SYSTEMS
Form 10-Q
October 14, 2016

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 August 31, 2016

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 X 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 X No ___

1

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

Large accelerated filer ---	Accelerated filer ---
Non-accelerated filer ---	Smaller reporting company X

(Do not check if a smaller reporting company)

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

Yes ___ No X

Number of shares of the registrant’s common stock, $0.01 par value, outstanding as of September 30, 2016 was 16,356,481.

AEHR TEST SYSTEMS

FORM 10-Q

FOR THE QUARTER ENDED AUGUST 31, 2016

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements (Unaudited)

Condensed Consolidated Balance Sheets at August 31, 2016 and May 31, 2016 4

Condensed Consolidated Statements of Operations for the Three Months Ended August 31, 2016 and 2015 5

Condensed Consolidated Statements of Comprehensive (Loss) Income for the Three Months Ended August 31, 2016 and 2015 6

Condensed Consolidated Statements of Cash Flows for the Three Months Ended August 31, 2016 and 2015 7

Notes to Condensed Consolidated Financial Statements. 8

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 18

ITEM 3. Quantitative and Qualitative Disclosures About Market Risks. 23

ITEM 4. Controls and Procedures 23

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings 24

ITEM 1A. Risk Factors 24

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds 31

ITEM 3. Defaults Upon Senior Securities 31

ITEM 4. Mine Safety Disclosures 31

ITEM 5. Other Information 31

ITEM 6. Exhibits 31

SIGNATURES 32

Index to Exhibits 33

3

PART I. FINANCIAL INFORMATION

Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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

	August 31, 2016	May 31, 2016 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$2,342	$939
Accounts receivable, net	1,774	522
Inventories	6,031	7,033
Prepaid expenses and other current assets	305	254
Total current assets	10,452	8,748
Property and equipment, net	789	1,204
Other assets	95	94
Total assets	$11,336	$10,046
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$1,906	1,413
Accrued expenses	1,372	1,553
Customer deposits and deferred revenue, short-term	2,724	1,714
Total current liabilities	6,002	4,680
Long-term debt, net of debt issuance costs	6,006	5,962
Deferred revenue, long-term	63	127
Total liabilities	12,071	10,769
Aehr Test Systems shareholders' deficit:		
Common stock, $0.01 par value: Authorized: 75,000;		

Issued and outstanding: 13,589 shares and 13,216 shares at August 31, 2016 and May 31, 2016, respectively	136	132
Additional paid-in capital	58,784	58,052
Accumulated other comprehensive income	2,245	2,237
Accumulated deficit	(61,879)	(61,124)
Total Aehr Test Systems shareholders' deficit	(714)	(703)
Noncontrolling interest	(21)	(20)
Total shareholders' deficit	(735)	(723)
Total liabilities and shareholders' deficit	$11,336	$10,046

(1)
The condensed consolidated balance sheet at May 31, 2016 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 August 31,	
	2016	2015
Net sales	$5,318	$6,633
Cost of sales	3,112	3,250
Gross profit	2,206	3,383
Operating expenses:		
Selling, general and administrative	1,716	1,845
Research and development	1,060	1,062
Total operating expenses	2,776	2,907
(Loss) income from operations	(570)	476
Interest expense	(178)	(135)
Other expense, net	(3)	(24)
(Loss) income before income tax expense	(751)	317
Income tax expense	(4)	(23)
Net (loss) income	(755)	294
Less: Net (loss) income attributable to the noncontrolling interest	--	--
Net (loss) income attributable to Aehr Test Systems common shareholders	$(755)	$294
Net (loss) income per share		
Basic	$(0.06)	$0.02
Diluted	$(0.06)	$0.02
Shares used in per share calculations:		

Basic	13,317	12,963
Diluted	13,317	13,814

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

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

	Three Months Ended August 31,	
	2016	2015
Net (loss) income	$(755)	$294
Other comprehensive income, net of tax: Net change in cumulative translation adjustments	7	18
Total comprehensive (loss) income	(748)	312
Less: Comprehensive loss attributable to the noncontrolling interest	(1)	--
Comprehensive (loss) income, attributable to Aehr Test Systems common shareholders	$(747)	$312

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)

	Three Months Ended August 31,	
	2016	2015
Cash flows from operating activities:		
Net (loss) income	$(755)	$294
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Stock-based compensation expense	319	319
Provision for doubtful accounts	20	19
Amortization of debt issuance costs	44	37
Depreciation and amortization	68	37
Changes in operating assets and liabilities:		
Accounts receivable	(1,250)	(1,257)
Inventories	1,374	(156)
Prepaid expenses and other current assets	(52)	(201)
Accounts payable	713	1,113
Accrued expenses	(181)	505
Customer deposits and deferred revenue	946	(2,804)
Income taxes payable	(2)	(2)
Net cash provided by (used in) operating activities	1,244	(2,096)
Cash flows from investing activities:		
Purchases of property and equipment	(21)	(21)
Net cash used in investing activities	(21)	(21)
Cash flows from financing activities:		
Proceeds from issuance of common stock under employee plans, net of taxes paid related to share settlement of equity awards	94	223
Net cash provided by financing activities	94	223
Effect of exchange rates on cash and cash equivalents	86	20
Net increase (decrease) in cash and cash equivalents	1,403	(1,874)
Cash and cash equivalents, beginning of period	939	5,527

Cash and cash equivalents, end of period	$2,342	$3,653
Supplemental disclosure of non-cash flow information:		
Net change in capitalized share-based compensation	$--	$(20)
Fair value of common stock issued to settle accounts payable	$323	$--
Transfers of property and equipment to inventories	$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

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, 2016 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 condensed consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2016. 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," "we," "us," and "our"). All significant intercompany balances have been eliminated in consolidation. For our majority owned subsidiary, Aehr Test Systems Japan K.K., we reflected the noncontrolling interest of the portion we do not own on our Condensed Consolidated Balance Sheets in Shareholders' Deficit 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. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ materially from those estimates.

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, 2016. There have been no changes in our significant accounting policies during the three months ended August 31, 2016.

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 an equity instrument. See Notes 10 and 11 in the Company's Annual Report on Form 10-K for fiscal 2016 filed on August 29, 2016 for further information regarding the stock option plan and the ESPP.

The following table summarizes the stock-based compensation expense related to the Company's stock-based incentive plans for the three months ended August 31, 2016 and 2015 (in thousands):

	Three Months Ended August 31,	
	2016	2015
Stock-based compensation in the form of employee stock options, RSUs and ESPP purchase rights, included in:		
Cost of sales	$24	$22
Selling, general and administrative	247	238
Research and development	48	59
Total stock-based compensation	$319	$319

As of August 31, 2016 and 2015, there were no stock-based compensation costs capitalized as part of inventory.

During the three months ended August 31, 2016 and 2015, the Company recorded stock-based compensation related to stock options and RSUs of $279,000 and $286,000, respectively.

As of August 31, 2016, the total compensation cost related to unvested stock-based awards under the Company's 1996 Stock Option Plan and 2006 Equity Incentive Plan, but not yet recognized, was approximately $1,258,000, 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 2.5 years.

During the three months ended August 31, 2016 and 2015, the Company recorded stock-based compensation related to the ESPP of $40,000 and $33,000, respectively.

As of August 31, 2016, the total compensation cost related to purchase rights under the ESPP but not yet recognized was approximately $98,000. This cost will be amortized on a straight-line basis over a weighted average period of approximately 1.1 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.

Expected 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.

Dividends. The Company has never paid any cash dividends on its common stock and does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model.

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.

Estimated Forfeitures. When estimating forfeitures, the Company considers voluntary termination behavior as well as analysis of actual option forfeitures.

Fair Value. The fair value of the Company's stock options granted to employees for the three months ended August 31, 2016 were estimated using the following weighted average assumptions in the Black-Scholes option valuation model:

	August 31, 2016
Expected term (in years)	4
Volatility	0.82
Expected dividend	$0.00
Risk-free interest rate	1.01%
Weighted average grant date fair value	$1.00

There were no stock options granted to employees for the three months ended August 31, 2015.

During the three months ended August 31, 2016, RSUs were granted for 138,000 shares. The market value on the date of the grant was $1.68 per share.

There were no ESPP purchase rights granted to employees for the three months ended August 31, 2016 and 2015.

The following tables summarize the Company's stock option and RSU transactions during three months ended August 31, 2016 (in thousands):

	Available Shares
Balance, May 31, 2016	1,847

Options granted	(318)
RSUs granted	(138)
Shares cancelled	46
Balance, August 31, 2016	1,437

The following table summarizes the stock option transactions during the three months ended August 31, 2016 (in thousands, except per share data):

	Outstanding Options		
	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balances, May 31, 2016	3,201	$1.66	$189
Options granted	318	$1.68	
Options cancelled	(46)	$1.40	
Options exercised	(91)	$1.32	
Balances, August 31, 2016	3,382	$1.67	$2,694
Options fully vested and expected to vest at August 31, 2016	3,314	$1.67	$2,640
Options exercisable at August 31, 2016	2,379	$1.52	$2,235

The options outstanding and exercisable at August 31, 2016 were in the following exercise price ranges (in thousands, except per share data):

	Options Outstanding at August 31, 2016			Options Exercisable at August 31, 2016			
Range of Exercise Prices	Number Outstanding Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
$0.59-$0.97	565	2.57	$0.68	565	2.57	$0.68	
$1.09-$1.40	1,039	3.03	$1.28	923	2.91	$1.28	
$1.68-$2.06	548	5.88	$1.77	215	4.60	$1.90	

$2.10-$2.71	1,230	5.20	$2.43	676	5.12	$2.45	
$0.59-$2.71	3,382	4.21	$1.67	2,379	3.61	$1.52	$ 2,235

The total intrinsic value of options exercised during the three months ended August 31, 2016 was $52,000. The total intrinsic value of options exercised during the three months ended August 31, 2015 was $60,000. The weighted average remaining contractual life of the options exercisable and expected to be exercisable at August 31, 2016 was 4.21 years.

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 employee stock purchase plan shares) outstanding during the period using the treasury stock method.

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

	Three Months Ended August 31,	
	2016	2015
Numerator: Net (loss) income	$(755)	$294
Denominator for basic net (loss) income per share:		
Weighted average shares outstanding	13,317	12,963
Shares used in basic net (loss) income per share calculation	13,317	12,963
Effect of dilutive securities	--	851
Denominator for diluted net (loss) income per share	13,317	13,814
Basic net (loss) income per share	$(0.06)	$0.02
Diluted net (loss) income per share	$(0.06)	$0.02

For the purpose of computing diluted earnings per share, the weighted average number of potential common shares does not include stock options with an exercise price greater than the average fair value of the Company's common stock for the period, as the effect would be anti-dilutive. In the three months ended August 31, 2016, 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 3,382,000 shares of common stock, RSUs for 74,000 shares and ESPP rights to purchase 304,000 ESPP shares were outstanding as of August 31, 2016 but were not included in the computation of diluted net loss per share, because the inclusion of such shares would be anti-dilutive. Stock options to purchase 1,371,000 shares of common stock and ESPP rights to purchase 175,000 ESPP shares were outstanding as of August 31, 2015, but were not included in the computation of diluted net loss per share, because the inclusion of such shares would be anti-dilutive.

4. 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.

The following table summarizes the Company's financial assets measured at fair value on a recurring basis as of August 31, 2016 (in thousands):

	Balance as of			
	August 31, 2016	Level 1	Level 2	Level 3
Money market funds	$1	$1	$--	$--
Certificate of deposit	50	--	50	--
Assets	$51	$1	$50	$--

The following table summarizes the Company's financial assets measured at fair value on a recurring basis as of May 31, 2016 (in thousands):

	Balance as of			
	May 31, 2016	Level 1	Level 2	Level 3
Money market funds	$1	$1	$--	$--
Certificate of deposit	50	--	50	--
Assets	$51	$1	$50	$--

There were no financial liabilities measured at fair value as of August 31, 2016 and May 31, 2016.

There were no transfers between Level 1 and Level 2 fair value measurements during the three months ended August 31, 2016 and May 31, 2016.

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.

5. ACCOUNTS RECEIVABLE, NET

Accounts receivable represents customer trade receivables and is presented net of allowance for doubtful accounts of $28,000 at August 31, 2016 and $8,000 at May 31, 2016. 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.

6. INVENTORIES

Inventories are comprised of the following (in thousands):

	August 31, 2016	May 31, 2016
Raw materials and sub-assemblies	$2,802	$2,839
Work in process	2,970	4,151
Finished goods	259	43
	$6,031	$7,033

7. 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 August 31, 2016:				
Net sales	$3,164	$1,910	$244	$5,318
Property and equipment, net	733	42	14	789
Three months ended August 31, 2015:				
Net sales	$718	$5,381	$534	$6,633
Property and equipment, net	418	34	13	465

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 96% of its net sales for the three months ended August 31, 2016 and 2015, respectively. Three customers accounted for approximately 42%, 27% and 17% of the Company’s net sales in the three months ended August 31, 2016. Two customers accounted for approximately 67% and 11% of the Company’s net sales in the three months ended August 31, 2015. No other customers represented more than 10% of the Company's net sales for either of the three months ended August 31, 2016 and 2015.

8. 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.

14

The following is a summary of changes in the Company's liability for product warranties during the three months ended August 31, 2016 and 2015 (in thousands):

	Three Months Ended August 31,	
	2016	2015
Balance at the beginning of the period	$155	$137
Accruals for warranties issued during the period	--	109
Accruals and adjustments (change in estimates) related to pre-existing warranties during the period	(54)	--
Settlement made during the period (in cash or in kind)	(11)	(27)
Balance at the end of the period	$90	$219

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

9. 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 - 2016 remain subject to examination by the appropriate governmental agencies due to tax loss carryovers from those years.

10. CUSTOMER DEPOSITS AND DEFERRED REVENUE, SHORT-TERM

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

	August 31, 2016	May 31, 2016
Customer deposits	$2,034	$540
Deferred revenue	690	1,174
	$2,724	$1,714

11. 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 is being accreted over the term of the original loan using the effective interest rate method, were offset against the loan balance. During three months ended August 31, 2016, $44,000 of amortization costs was recognized as interest expense. Unamortized debt issuance costs of $104,000 were offset against the loan balance at August 31, 2016.

The conversion price for the Convertible Notes is $2.30 per share of the Company's common stock and is subject to adjustment upon the occurrence of certain specified events (as adjusted, the "Conversion Price"). 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.

On April 14, 2016, $900,000 drawn against the Credit Facility was converted to Convertible Notes. On July 17, 2016, $1,100,000 drawn against the Credit Facility was converted to Convertible Notes. At August 31, 2016 there was no remaining balance on the Credit Facility.

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

Long-term debt, net of debt issuance costs (in thousands):

	August 31, 2016	May 31, 2016
Principal	$6,110	$6,110
Unamortized debt issuance costs	(104)	(148)
	$6,006	$5,962

12. EQUITY

On August 8, 2016 the Company issued 200,000 shares of its common stock to Semics Inc., a semiconductor test equipment provider that produces fully automatic wafer probe systems, in consideration for cancellation of an outstanding invoice of $323,000 for capital equipment.

13. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, as part of its ongoing efforts to assist in the convergence of US GAAP and International Financial Reporting Standards (“IFRS”), the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606).” The new guidance 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 US 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 ASU provides alternative methods of initial adoption and will become effective for us 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 (ASU 2015-14). ii) clarify the application of the principal versus agent guidance (ASU 2016-08). and iii) clarify the guidance on inconsequential and perfunctory promises and licensing (ASU 2016-10). In May 2016, the FASB issued ASU 2016-12, ‘Revenue from Contracts with Customers (Topic 606) Narrow-Scope Improvements and Practical Expedients”, 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. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Going Concern. This standard requires management to evaluate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern and whether or not it is probable that the entity will be unable to meet its obligations as they become due within one year after the date the financial statements are issued. The new standard will apply to all entities and will be effective for us in fiscal year 2017, with early adoption permitted. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Inventory. This standard 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. This new standard will be effective for us in fiscal year 2018, with early adoption permitted. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

In November 2015, FASB issued ASU No. 2015-17, Income Taxes. This standard simplifies the presentation of deferred income taxes to be classified as noncurrent in the consolidated balance sheet. This new standard will be effective for us in fiscal year 2018, with early adoption permitted. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, Leases. This standard 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.

In January 2016, FASB issued ASU No. 2016-01, 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. ASU 2016-01 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 March 2016, FASB released ASU 2016-09, Compensation - Stock Compensation. The standard 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 accounting standard will be effective for the Company beginning the first quarter of fiscal 2018, and early adoption is permitted. The Company is currently evaluating the impact of this new guidance on its consolidated financial statements.

14. SUBSEQUENT EVENT:

On September 28, 2016, the Company sold 2,721,540 shares of its common stock in a private placement transaction with certain institutional and accredited investors. The purchase price per share of the common stock sold in the private placement was $2.15, resulting in gross proceeds to the Company of $5,851,000, before offering expenses. The net proceeds after offering expenses were $5,389,000.

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 of the Company 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, 2016 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

The Company was founded in 1977 to develop and manufacture burn-in and test equipment for the semiconductor industry. Since its inception, the Company has sold more than 2,500 systems to semiconductor manufacturers, semiconductor contract assemblers and burn-in and test service companies worldwide. The Company's principal products currently are the Advanced Burn-in and Test System, or ABTS, the FOX full wafer contact parallel test and burn-in system, the MAX burn-in system, WaferPak contactors, the DiePak carrier and test fixtures.

18

The Company’s net sales consist primarily of sales of systems, WaferPak contactors, test fixtures, die carriers, upgrades and spare parts, revenues from service contracts, and engineering development charges. The Company's 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

The Company’s discussion and analysis of its financial condition and results of operations are based upon the Company’s 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 the Company 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, the Company evaluates its 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. The Company’s 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 the Company’s Annual Report on Form 10-K for the fiscal year ended May 31, 2016.

There have been no material changes to our critical accounting policies and estimates during the three months ended August 31, 2016 compared to those discussed in our Annual Report on Form 10-K for the fiscal year ended May 31, 2016.

RESULTS OF OPERATIONS

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

	Three Months Ended August 31,	
	2016	2015
Net sales	100.0%	100.0%
Cost of sales	58.5	49.0
Gross profit	41.5	51.0
Operating expenses:		
Selling, general and administrative	32.3	27.8
Research and development	19.9	16.0
Total operating expenses	52.2	43.8
(Loss) income from operations	(10.7)	7.2
Interest expense	(3.3)	(2.0)
Other expense, net	(0.1)	(0.4)
(Loss) income before income tax expense	(14.1)	4.8
Income tax expense	(0.1)	(0.4)
Net (loss) income	(14.2)	4.4
Less: Net (loss) income attributable to the noncontrolling interest	--	--
Net (loss) income attributable to Aehr Test Systems common shareholders	(14.2)%	4.4%

THREE MONTHS ENDED AUGUST 31, 2016 COMPARED TO THREE MONTHS ENDED AUGUST 31, 2015

NET SALES. Net sales decreased to $5.3 million for the three months ended August 31, 2016 from $6.6 million for the three months ended August 31, 2015, a decrease of 19.8%. The decrease in net sales for the three months ended August 31, 2016 was primarily due to the decrease in net sales of the Company's wafer-level products, partially offset by an increase in net sales of the Company's Test During Burn-in (TDBI) products. Net sales of the Company's wafer-level products for the three months ended August 31, 2016 were $2.7 million, and decreased approximately $2.5 million from the three months ended August 31, 2015. Net sales of the TDBI products for the three months ended

August 31, 2016 were $2.6 million, and increased approximately $1.2 million from the three months ended August 31, 2015.

GROSS PROFIT. Gross profit consists of net sales less cost of sales. Cost of sales consists primarily of the cost of materials, assembly and test costs, and overhead from operations. Gross profit decreased to $2.2 million for the three months ended August 31, 2016 from $3.4 million for the three months ended August 31, 2015, a decrease of approximately 34.8%. Gross profit margin, the percentage of gross profit to net sales, decreased to 41.5% for the three months ended August 31, 2016 from 51.0% for the three months ended August 31, 2015. The higher gross profit margin for the three months ended August 31, 2015 was primarily due to sales of certain systems which included previously written-down material.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative, or SG&A, expenses consist primarily of salaries and related costs of employees, commission expenses to independent sales representatives, product promotion and other professional services. SG&A expenses decreased to $1.7 million for the three months ended August 31, 2016 from $1.8 million for the three months ended August 31, 2015, a decrease of 7.0%. The decrease in SG&A expenses was primarily due to the decrease in sales commission to outside sales representatives.

RESEARCH AND DEVELOPMENT. Research and development, or R&D, expenses consist primarily of salaries and related costs of employees engaged in ongoing research, design and development activities, costs of engineering materials and supplies, and professional consulting expenses. R&D expenses stayed flat at $1.1 million for the three months ended August 31, 2016 and 2015.

INTEREST EXPENSE. Interest expense was $178,000 for the three months ended August 31, 2016 compared with $135,000 for the three months ended August 31, 2015. The increase in interest expense in the three months ended August 31, 2016 was primarily due to expenses related to the convertible debt financing.

OTHER EXPENSE, NET. Other expense, net was $3,000 for the three months ended August 31, 2016, compared with other expense, net of $24,000 for the three months ended August 31, 2015. 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 EXPENSE. Income tax expense was $4,000 for the three months ended August 31, 2016, compared with an income tax expense of $23,000 for the three months ended August 31, 2015.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was $1.2 million for the three months ended August 31, 2016 and cash used in operating activities was $2.1 million for the three months ended August 31, 2015. For the three months ended August 31, 2016, net cash provided by operating activities was primarily the result of increases in customer deposits and deferred revenue of $0.9 million and accounts payable of $0.7 million and decrease in inventories of $1.4 million. This was partially offset by an increase in accounts receivable of $1.3 million and the net loss of $0.8 million as adjusted to exclude the effect of non-cash charges of stock-based compensation expense of $0.3 million. The increase in customer deposits and deferred revenue was primarily due to the receipt of additional down payments from certain customers. The increase in accounts payable was primarily due to higher expenditures associated with higher revenue. The decrease in inventories is primarily due to the sales of systems on-hand at the beginning of the period. The increase in accounts receivable was primarily due to an increase in sales. For the three months ended August 31, 2015, net cash used in operating activities was primarily the result of a decrease in customer deposits and deferred revenue of $2.8 million, and an increase in accounts receivable of $1.3 million. This was partially offset by an increase in accounts payables of $1.1 million, accrued liabilities of $0.5 million, and net income of $0.3 million, as adjusted to exclude the effect of non-cash charge of stock-based compensation expense of $0.3 million. The decrease in customer deposits and deferred revenue was primarily due to the shipments of customer orders with down payments. The increase in accounts receivable was primarily due to an increase in sales. The increase in accounts payable was primarily due to higher expenditures associated with higher revenue.

Net cash used in investing activities was $21,000 each for the three months ended August 31, 2016 and 2015. Net cash used in investing activities was due to purchases of property and equipment.

Net cash provided by financing activities was $94,000 and $223,000 for the three months ended August 31, 2016 and 2015, respectively. Net cash provided by financing activities during the three months ended August 31, 2016 and 2015 was primarily due to proceeds from the exercise of stock options.

The effect of fluctuation in exchange rates provided cash of $86,000 and $20,000 for the three months ended August 31, 2016 and 2015, respectively. The change in cash provided was due to the fluctuation in the value of the dollar compared to foreign currencies.

As of August 31, 2016 and May 31, 2016, the Company had working capital of $4.5 million and $4.1 million, respectively. Working capital consists of cash and cash equivalents, accounts receivable, inventory and other current assets, less current liabilities.

The Company leases its manufacturing and office space under operating leases. The Company entered into a non-cancelable operating lease agreement for its United States manufacturing and office facilities, which was renewed in November 2014 and expires in June 2018. Under the lease agreement, the Company is responsible for payments of utilities, taxes and insurance.

From time to time, the Company evaluates potential acquisitions of businesses, products or technologies that complement the Company’s business. If consummated, any such transactions may use a portion of the Company’s working capital or require the issuance of equity. The Company has no present understandings, commitments or agreements with respect to any material acquisitions.

The Company anticipates 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 its short-term working capital and capital equipment requirements. On August 22, 2016, the Company extended the maturity date of its 9.0% Convertible Secured Notes due 2017 (the “Convertible Notes”) to April 10, 2019 which improves our ability to meet current liabilities for fiscal 2017. On September 28, 2016, the Company sold 2,721,540 shares of its common stock in a private placement transaction resulting in net proceeds after offering expenses of $5,389,000 to the Company. Refer to Note 14, “SUBSEQUENT EVENT”. Depending on our rate of growth and profitability, and our ability to obtain significant orders with down payments, the Company may require additional equity or debt financing to meet its working capital requirements or capital equipment needs. There can be no assurance that additional financing will be available when required, or if available, that such financing can be obtained on terms satisfactory to the Company.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any off-balance sheet financing arrangements and has not established any variable interest entities.

OVERVIEW OF CONTRACTUAL OBLIGATIONS

On April 10, 2015, the Company entered into a Convertible Note Purchase and Credit Facility Agreement providing for the Company’s sale of the Convertible Notes and a secured revolving loan facility. On August 22, 2016, the Company entered into an amendment to the Convertible Note Purchase and Credit Facility Agreement and the Convertible Notes to extend the maturity date of the Convertible Notes to April 10, 2019. See Note 11, “LONG-TERM DEBT”, for a description of the Convertible Note Purchase and Credit Facility Agreement and the Convertible Notes.

There have been no additional material changes in the composition, magnitude or other key characteristics of the Company's contractual obligations or other commitments as disclosed in the Company's Annual Report on Form 10-K for the year ended May 31, 2016.

22

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company had no holdings of derivative financial or commodity instruments as of August 31, 2016 or May 31, 2016.

The Company is exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. The Company only invests its short-term excess cash in government-backed securities with maturities of 18 months or less. The Company does not use any financial instruments for speculative or trading purposes. Fluctuations in interest rates would not have a material effect on the Company's financial position, results of operations or cash flows.

A majority of the Company's revenue and capital spending is transacted in U.S. Dollars. The Company, however, enters into transactions in other currencies, primarily Euros and Japanese Yen. Since the price is determined at the time a purchase order is accepted, the Company is 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 the Company's subsidiaries incur expenses payable in their local currency. To date, the Company has not invested in instruments designed to hedge currency risks. In addition, the Company's subsidiaries typically carry debt or other obligations due to the Company that may be denominated in either their local currency or U.S. Dollars. Since the Company's subsidiaries' financial statements are based in their local currency and the Company's condensed consolidated financial statements are based in U.S. Dollars, the Company's subsidiaries and the Company 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 the Company's 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

You should carefully consider the risks described below. These risks are not the only risks that we may face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected which could cause our actual operating results to differ materially from those indicated or suggested by forward-looking statements made in this Quarterly Report on Form 10-Q and in other documents we filed with the U.S. Securities and Exchange Commission, including without limitation our most recently filed Annual Report on Form 10-K or presented elsewhere by management from time to time.

If we are not able to reduce our operating expenses sufficiently during periods of weak revenue, or if we utilize significant amounts of cash to support operating losses, we may erode our cash resources and may not have sufficient cash to operate our business.

In recent years, in the face of a downturn in our business and a decline in our net sales, we implemented a variety of cost controls and restructured our operations with the goal of reducing our operating costs to position ourselves to more effectively meet the needs of the then weak market for test and burn-in equipment. While we took significant steps to minimize our expense levels and to increase the likelihood that we would have sufficient cash to support operations during the downturn, from fiscal 2009 through fiscal 2016, with the exception of fiscal 2014, we experienced operating losses. The Company anticipates 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 its short-term working capital and capital equipment requirements. The Company extended the maturity date of its 9.0% Convertible Secured Notes due 2017 (the “Convertible Notes”) to April 10, 2019 which improves our ability to meet current liabilities for fiscal 2017. Refer to Note 11 of Notes to Condensed Consolidated Financial Statements, “LONG-TERM DEBT” for further discussion of the Convertible Notes. Depending on our rate of growth and profitability, and our ability to obtain significant orders with down payments, we may require additional equity or debt financing to meet our working capital requirements or capital equipment needs. There can be no assurance that additional financing will be available when required, or if available, that such financing can be obtained on terms satisfactory to the Company.

Our common stock may be delisted from The NASDAQ Capital Market if we cannot maintain compliance with NASDAQ’s continued listing requirements.

In order to maintain our listing on The NASDAQ Capital Market, we are required to maintain compliance with NASDAQ’s continued listing requirements. The continued listing requirements include, among others, a minimum bid price of $1.00 per share and any of: (i) a minimum stockholders’ equity of $2.5 million; (ii) a market value of listed securities of at least $35 million; or (iii) net income from continuing operations of $500,000 in the most recently completed fiscal year or in two of the last three fiscal years. There are no assurances that we will be able to sustain long-term compliance with NASDAQ’s continued listing requirements. On April 19, 2016 the Company was notified by NASDAQ that it was no longer in compliance with NASDAQ’s continued listing requirements as we did not have a minimum stockholders’ equity of $2.5 million. On October 3, 2016, the Company was notified by NASDAQ that the Company had regained compliance with NASDAQ’s continued listing requirements. If we fail to maintain compliance

with the applicable NASDAQ continued listing requirements, our stock may be delisted.

If we are delisted, we would expect our common stock to be traded in the over-the-counter market, which could make trading our common stock more difficult for investors, potentially leading to declines in our share price and liquidity. Delisting from The NASDAQ Capital Market would also constitute an event of default under our Convertible Notes. In addition, delisting could result in negative publicity and make it more difficult for us to raise additional capital.

We rely on increasing market acceptance for our FOX system, and we may not be successful in attracting new customers or maintaining our existing customers.

A principal element of our business strategy is to increase our presence in the test equipment market through system sales in our FOX wafer-level test and burn-in product family. The FOX system is designed to simultaneously functionally test and burn-in all of the die on a wafer on a single touchdown. The market for the FOX systems is in the early stages of development. Market acceptance of the FOX system is subject to a number of risks. Before a customer will incorporate the FOX system into a production line, lengthy qualification and correlation tests must be performed. We anticipate that potential customers may be reluctant to change their procedures in order to transfer burn-in and test functions to the FOX system. Initial purchases are expected to be limited to systems used for these qualifications and for engineering studies. Market acceptance of the FOX system also may be affected by a reluctance of IC manufacturers to rely on relatively small suppliers such as us. As is common with new complex products incorporating leading-edge technologies, we may encounter reliability, design and manufacturing issues as we begin volume production and initial installations of FOX systems at customer sites. The failure of the FOX system to achieve increased market acceptance would have a material adverse effect on our future operating results, long-term prospects and our stock price.

The semiconductor equipment industry is intensely competitive. In each of the markets it serves, the Company faces competition from established competitors and potential new entrants, many of which have greater financial, engineering, manufacturing and marketing resources than the Company.

The Company’s FOX full wafer contact systems face competition from larger systems manufacturers that have significant technological know-how and manufacturing capability. The Company’s ABTS Test During Burn-in (TDBI) systems have faced and are expected to continue to face increasingly severe competition, especially from several regional, low-cost manufacturers and from systems manufacturers that offer higher power dissipation per device under test. Some users of such systems, such as independent test labs, build their own burn-in systems, while others, particularly large IC manufacturers in Asia, acquire burn-in systems from captive or affiliated suppliers. The Company’s WaferPak products are facing and are expected to face increasing competition. Several companies have developed or are developing full-wafer and single-touchdown probe cards.

The Company expects its competitors to continue to improve the performance of their current products and to introduce new products with improved price and performance characteristics. New product introductions by the Company’s competitors or by new market entrants could cause a decline in sales or loss of market acceptance of the Company’s products. The Company has observed price competition in the systems market, particularly with respect to its less advanced products. Increased competitive pressure could also lead to intensified price-based competition, resulting in lower prices which could adversely affect the Company’s operating margins and results. The Company believes that to remain competitive it must invest significant financial resources in new product development and expand its customer service and support worldwide. There can be no assurance that the Company will be able to compete successfully in the future.

We rely on continued market acceptance of our ABTS system and our ability to complete certain enhancements.

Continued market acceptance of the ABTS family, first introduced in fiscal 2008, is subject to a number of risks. It is important that we achieve customer acceptance, customer satisfaction and increased market acceptance as we add new features and enhancements to the ABTS product. To date, the Company has shipped ABTS systems to customers worldwide for use in both reliability and production applications. The Company has recognized a weakening of ABTS product sales over the past few quarters. The failure of the ABTS family to increase revenues above current levels would have a material adverse effect on our future operating results.

We generate a large portion of our sales from a small number of customers. If we were to lose one or more of our large customers, operating results could suffer dramatically.

The semiconductor manufacturing industry is highly concentrated, with a relatively small number of large semiconductor manufacturers and contract assemblers accounting for a substantial portion of the purchases of semiconductor equipment. Sales to the Company's five largest customers accounted for approximately 94%, 79%, and 90% of its net sales in fiscal 2016, 2015 and 2014, respectively. During fiscal 2016, Apple and Texas Instruments accounted for approximately 47% and 32%, respectively, of the Company's net sales. During fiscal 2015, Texas Instruments and Micronas accounted for approximately 45% and 11%, respectively, of the Company's net sales. During fiscal 2014, Texas Instruments, Spansion and Micronas accounted for approximately 40%, 30% and 12%, respectively, of the Company's net sales. No other customers accounted for more than 10% of the Company's net sales for any of these periods.

We expect that sales of our products to a limited number of customers will continue to account for a high percentage of net sales for the foreseeable future. In addition, sales to particular customers may fluctuate significantly from quarter to quarter. The loss of, reduction or delay in an order, or orders from a significant customer, or a delay in collecting or failure to collect accounts receivable from a significant customer could adversely affect our business, financial condition and operating results.

A substantial portion of our net sales is generated by relatively small volume, high value transactions.

We derive a substantial portion of our net sales from the sale of a relatively small number of systems which typically range in purchase price from approximately $300,000 to well over $1 million per system. As a result, the loss or deferral of a limited number of system sales could have a material adverse effect on our net sales and operating results in a particular period. Most customer purchase orders are subject to cancellation or rescheduling by the customer with limited penalties, and, therefore, backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. From time to time, cancellations and rescheduling of customer orders have occurred, and delays by our suppliers in providing components or subassemblies to us have caused delays in our shipments of our own products. There can be no assurance that we will not be materially adversely affected by future cancellations or rescheduling. For non-standard products where we have not effectively demonstrated the ability to meet specifications in the customer environment, we defer revenue until we have met such customer specifications. Any delay in meeting customer specifications could have a material adverse effect on our operating results. A substantial portion of net sales typically are realized near the end of each quarter. A delay or reduction in shipments near the end of a particular quarter, due, for example, to unanticipated shipment rescheduling, cancellations or deferrals by customers, customer credit issues, unexpected manufacturing difficulties experienced by us or delays in deliveries by suppliers, could cause net sales in a particular quarter to fall significantly below our expectations.

We may experience increased costs associated with new product introductions.

As is common with new complex products incorporating leading-edge technologies, we have encountered reliability, design and manufacturing issues as we began volume production and initial installations of certain products at customer sites. Some of these issues in the past have been related to components and subsystems supplied to us by third parties who have in some cases limited the ability of us to address such issues promptly. This process in the past required and in the future is likely to require us to incur un-reimbursed engineering expenses and to experience larger than anticipated warranty claims which could result in product returns. In the early stages of product development there can be no assurance that we will discover any reliability, design and manufacturing issues or, that if such issues arise, that they can be resolved to the customers' satisfaction or that the resolution of such problems will not cause us to incur significant development costs or warranty expenses or to lose significant sales opportunities.

Periodic economic and semiconductor industry downturns could negatively affect our business, results of operations and financial condition.

Periodic global economic and semiconductor industry downturns have negatively affected and could continue to negatively affect our business, results of operations, and financial condition. Financial turmoil in the banking system and financial markets has resulted, and may result in the future, in a tightening of the credit markets, disruption in the financial markets and global economy downturn. These events may contribute to significant slowdowns in the industry in which we operate. Difficulties in obtaining capital and deteriorating market conditions can pose the risk that some of our customers may not be able to obtain necessary financing on reasonable terms, which could result in lower sales for the Company. Customers with liquidity issues may lead to additional bad debt expense for the Company.

Turmoil in the international financial markets has resulted, and may result in the future, in dramatic currency devaluations, stock market declines, restriction of available credit and general financial weakness. In addition, flash, DRAM and other memory device prices have historically declined, and will likely do so again in the future. These developments may affect us in several ways. The market for semiconductors and semiconductor capital equipment has historically been cyclical, and we expect this to continue in the future. The uncertainty of the semiconductor market may cause some manufacturers in the future to further delay capital spending plans. Economic conditions may also affect the ability of our customers to meet their payment obligations, resulting in cancellations or deferrals of existing orders and limiting additional orders. In addition, some governments have subsidized portions of fabrication facility construction, and financial turmoil may reduce these governments' willingness to continue such subsidies. Such developments could have a material adverse effect on our business, financial condition and results of operations.

The recent economic conditions and uncertainty about future economic conditions make it challenging for us to forecast our operating results, make business decisions, and identify the risks that may affect our business, financial condition and results of operations. If such conditions recur, and we are not able to timely and appropriately adapt to changes resulting from the difficult macroeconomic environment, our business, financial condition or results of operations may be materially and adversely affected.

We sell our products and services worldwide, and our business is subject to risks inherent in conducting business activities in geographic regions outside of the United States.

Approximately 80%, 64%, and 56% of our net sales for fiscal 2016, 2015 and 2014, respectively, were attributable to sales to customers for delivery outside of the United States. We operate a sales, service and limited manufacturing organization in Germany and sales and service organizations in Japan and Taiwan. We expect that sales of products for delivery outside of the United States will continue to represent a substantial portion of our future net sales. Our future performance will depend, in significant part, upon our ability to continue to compete in foreign markets which in turn will depend, in part, upon a continuation of current trade relations between the United States and foreign countries in which semiconductor manufacturers or assemblers have operations. A change toward more protectionist trade legislation in either the United States or such foreign countries, such as a change in the current tariff structures, export compliance or other trade policies, could adversely affect our ability to sell our products in foreign markets. In addition, we are subject to other risks associated with doing business internationally, including longer receivable collection periods and greater difficulty in accounts receivable collection, the burden of complying with a variety of foreign laws, difficulty in staffing and managing global operations, risks of civil disturbance or other events which may limit or disrupt markets, international exchange restrictions, changing political conditions and monetary policies of foreign governments.

Approximately 97%, 2% and 1% of our net sales for fiscal 2016 were denominated in U.S. Dollars, Euros and Japanese Yen, respectively. Although the percentages of net sales denominated in Euros and Japanese Yen were small in fiscal 2016, they have been larger in the past and could become significant again in the future. A large percentage of net sales to European customers are denominated in U.S. Dollars, but sales to many Japanese customers are denominated in Japanese Yen. Because a substantial portion of our net sales is from sales of products for delivery outside the United States, an increase in the value of the U.S. Dollar relative to foreign currencies would increase the cost of our products compared to products sold by local companies in such markets. In addition, since the price is determined at the time a purchase order is accepted, we are exposed to the risks of fluctuations in the U.S. Dollar exchange rate during the lengthy period from the date a purchase order is received until payment is made. This exchange rate risk is partially offset to the extent our foreign operations incur expenses in the local currency. To date, we have not invested in any instruments designed to hedge currency risks. Our operating results could be adversely affected by fluctuations in the value of the U.S. Dollar relative to other currencies.

Our industry is subject to rapid technological change and our ability to remain competitive depends on our ability to introduce new products in a timely manner.

The semiconductor equipment industry is subject to rapid technological change and new product introductions and enhancements. Our ability to remain competitive depends in part upon our ability to develop new products and to introduce them at competitive prices and on a timely and cost-effective basis. Our success in developing new and enhanced products depends upon a variety of factors, including product selection, timely and efficient completion of product design, timely and efficient implementation of manufacturing and assembly processes, product performance in the field and effective sales and marketing. Because new product development commitments must be made well in advance of sales, new product decisions must anticipate both future demand and the technology that will be available to supply that demand. Furthermore, introductions of new and complex products typically involve a period in which design, engineering and reliability issues are identified and addressed by our suppliers and by us. There can be no assurance that we will be successful in selecting, developing, manufacturing and marketing new products that satisfy market demand. Any such failure would materially and adversely affect our business, financial condition and results of operations.

Because of the complexity of our products, significant delays can occur between a product's introduction and the commencement of the volume production of such product. We have experienced, from time to time, significant delays in the introduction of, and technical and manufacturing difficulties with, certain of our products and may experience delays and technical and manufacturing difficulties in future introductions or volume production of our new products. Our inability to complete new product development, or to manufacture and ship products in time to meet customer requirements would materially adversely affect our business, financial condition and results of operations.

Our dependence on subcontractors and sole source suppliers may prevent us from delivering our products on a timely basis and expose us to intellectual property infringement.

We rely on subcontractors to manufacture many of the components or subassemblies used in our products. Our FOX and ABTS systems and WaferPak contactors contain several components, including environmental chambers, power supplies, high-density interconnects, wafer contactors, signal distribution substrates, WaferPak Aligners and certain ICs that are currently supplied by only one or a limited number of suppliers. Our reliance on subcontractors and single source suppliers involves a number of significant risks, including the loss of control over the manufacturing process, the potential absence of adequate capacity and reduced control over delivery schedules, manufacturing yields, quality and costs. In the event that any significant subcontractor or single source supplier is unable or unwilling to continue to manufacture subassemblies, components or parts in required volumes, we would have to identify and qualify acceptable replacements. The process of qualifying subcontractors and suppliers could be lengthy, and no assurance can be given that any additional sources would be available to us on a timely basis. Any delay, interruption or termination of a supplier relationship could adversely affect our ability to deliver products, which would harm our operating results.

Our suppliers manufacture components, tooling, and provide engineering services. During this process, our suppliers are allowed access to intellectual property of the Company. While the Company maintains patents to protect from intellectual property infringement, there can be no assurance that technological information gained in the manufacture of our products will not be used to develop a new product, improve processes or techniques which compete against our products. Litigation may be necessary to enforce or determine the validity and scope of our proprietary rights, and there can be no assurance that our intellectual property rights, if challenged, will be upheld as valid.

Future changes in semiconductor technologies may make our products obsolete.

Future improvements in semiconductor design and manufacturing technology may reduce or eliminate the need for our products. For example, improvements in semiconductor process technology and improvements in conventional test systems, such as reduced cost or increased throughput, may significantly reduce or eliminate the market for one or more of our products. If we are not able to improve our products or develop new products or technologies quickly enough to maintain a competitive position in our markets, our business may decline.

Our stock price may fluctuate.

The price of our common stock has fluctuated in the past and may fluctuate significantly in the future. We believe that factors such as announcements of developments related to our business, fluctuations in our operating results, general conditions in the semiconductor and semiconductor equipment industries as well as the worldwide economy, announcement of technological innovations, new systems or product enhancements by us or our competitors, fluctuations in the level of cooperative development funding, acquisitions, changes in governmental regulations, developments in patents or other intellectual property rights and changes in our relationships with customers and suppliers could cause the price of our common stock to fluctuate substantially. In addition, in recent years the stock

market in general, and the market for small capitalization and high technology stocks in particular, have experienced extreme price fluctuations which have often been unrelated to the operating performance of the affected companies. Such fluctuations could adversely affect the market price of our common stock.

We depend on our key personnel and our success depends on our ability to attract and retain talented employees.

Our success depends to a significant extent upon the continued service of Gayn Erickson, our President and Chief Executive Officer, as well as other executive officers and key employees. We do not maintain key person life insurance for our benefit on any of our personnel, and none of our employees are subject to a non-competition agreement with us. The loss of the services of any of our executive officers or a group of key employees could have a material adverse effect on our business, financial condition and operating results. Our future success will depend in significant part upon our ability to attract and retain highly skilled technical, management, sales and marketing personnel. There is a limited number of personnel with the requisite skills to serve in these positions, and it has become increasingly difficult for us to hire such personnel. Competition for such personnel in the semiconductor equipment industry is intense, and there can be no assurance that we will be successful in attracting or retaining such personnel. Changes in management could disrupt our operations and adversely affect our operating results.

We may be subject to litigation relating to intellectual property infringement which would be time-consuming, expensive and a distraction from our business.

If we do not adequately protect our intellectual property, competitors may be able to use our proprietary information to erode our competitive advantage, which could harm our business and operating results. Litigation may be necessary to enforce or determine the validity and scope of our proprietary rights, and there can be no assurance that our intellectual property rights, if challenged, will be upheld as valid. Such litigation could result in substantial costs and diversion of resources and could have a material adverse effect on our operating results, regardless of the outcome of the litigation. In addition, there can be no assurance that any of the patents issued to us will not be challenged, invalidated or circumvented or that the rights granted thereunder will provide competitive advantages to us.

There are no pending claims against us regarding infringement of any patents or other intellectual property rights of others. However, in the future we may receive communications from third parties asserting intellectual property claims against us. Such claims could include assertions that our products infringe, or may infringe, the proprietary rights of third parties, requests for indemnification against such infringement or suggestions that we may be interested in acquiring a license from such third parties. There can be no assurance that any such claim will not result in litigation, which could involve significant expense to us, and, if we are required or deem it appropriate to obtain a license relating to one or more products or technologies, there can be no assurance that we would be able to do so on commercially reasonable terms, or at all.

While we believe we have complied with all applicable environmental laws, our failure to do so could adversely affect our business as a result of having to pay substantial amounts in damages or fees.

Federal, state and local regulations impose various controls on the use, storage, discharge, handling, emission, generation, manufacture and disposal of toxic and other hazardous substances used in our operations. We believe that our activities conform in all material respects to current environmental and land use regulations applicable to our operations and our current facilities, and that we have obtained environmental permits necessary to conduct our business. Nevertheless, failure to comply with current or future regulations could result in substantial fines, suspension of production, alteration of our manufacturing processes or cessation of operations. Such regulations could require us to acquire expensive remediation equipment or to incur substantial expenses to comply with environmental regulations. Any failure to control the use, disposal or storage of or adequately restrict the discharge of, hazardous or toxic substances could subject us to significant liabilities.

If we fail to maintain effective internal control over financial reporting in the future, the accuracy and timing of our financial reporting may be adversely affected.

We are required to comply with Section 404 of the Sarbanes-Oxley Act of 2002. The provisions of the act require, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. Preparing our financial statements involves a number of complex processes, many of which are done manually and are dependent upon individual data input or review. These processes include, but are not limited to, calculating revenue, deferred revenue and inventory costs. While we continue to automate our processes and enhance our review and put in place controls to reduce the likelihood for errors, we expect that for the foreseeable future, many of our processes will remain manually intensive and thus subject to human error.

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

On August 8, 2016 the Company issued 200,000 shares of its common stock to Semics Inc., a semiconductor test equipment provider that produces fully automatic wafer probe systems, in consideration for cancellation of an outstanding invoice of $323,000 for capital equipment. These shares were issued without registration under the Securities Act of 1933, as amended, in reliance on the exemptions provided by Section 4(2) of the Securities Act of 1933, as amended, and as such the shares may not be offered or sold in the United States absent registration under such act and applicable state securities laws or an applicable exemption from those registration requirements.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. MINE SAFETY DISCLOSURES

Not Applicable

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

The Exhibits listed on the accompanying "Index to Exhibits" are filed as part of, or incorporated by reference into, this report.

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: October 14, 2016

/s/ GAYN ERICKSON
Gayn Erickson
President and Chief Executive Officer

Date: October 14, 2016

/s/ KENNETH B. SPINK
Kenneth B. Spink
Vice President of Finance and Chief Financial Officer

32

AEHR TEST SYSTEMS
INDEX TO EXHIBITS

Exhibit No.	Description
10.1(1)	Amendment to the Aehr Test Systems Convertible Note Purchase and Credit Facility Agreement and 9.0% Notes.
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. 10.1 previously filed with the Company's Current Report on Form 8-K filed August 24, 2016 (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.