ALLIANCE FIBER OPTIC PRODUCTS INC

FORM 10-Q
(Quarterly Report)

Filed 08/12/09 for the Period Ending 06/30/09

Address	275 GIBRALTAR DRIVE SUNNYVALE, CA 94089
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

☐ 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 0-31857

ALLIANCE FIBER OPTIC PRODUCTS, INC.
(Exact name of registrant as specified in its charter)

Delaware	77-0554122
(State or other jurisdiction of Incorporation or organization)	(I.R.S. employer identification number)

275 Gibraltar Drive, Sunnyvale, California 94089
(Address of Principal Executive Offices)

(408) 736-6900
(Issuer's telephone number)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ? No ☐

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

Large accelerated filer ☐ Accelerated Filer ☐ Non-accelerated filer ☐ Smaller reporting company ☑
(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 ☑

On August 3, 2009, 42,164,247 shares of the registrant's Common Stock, $0.001 par value per share, were outstanding.

ALLIANCE FIBER OPTIC PRODUCTS, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED JUNE 30, 2009

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PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

ALLIANCE FIBER OPTIC PRODUCTS, INC.
Condensed Consolidated Balance Sheets
(In thousands, except share data)

	June 30, 2009 (Unaudited)	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 7,348	$ 12,185
Short-term investments	31,622	11,769
Accounts receivable, net	5,062	4,708
Inventories, net	4,816	5,614
Prepaid expense and other current assets	2,387	379
Total current assets	51,235	34,655
Long-term investments	-	13,718
Property and equipment, net	4,382	4,653
Other assets	189	2,772
Total assets	$ 55,806	$ 55,798
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 3,005	$ 3,572
Accrued expenses	2,996	3,237
Current portion of bank loan	132	137
Total current liabilities	6,133	6,946
Long-term liabilities		
Bank loan	349	413
Other long-term liabilities	481	478
Total long term liabilities	830	891
Total liabilities	6,963	7,837
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock, $0.001 par value: 250,000,000 shares authorized; 42,164,247 and 42,001,635 shares issued and outstanding at June 30, 2009 and December 31, 2008.	42	42
Additional paid-in-capital	111,857	111,687
Accumulated deficit	(63,646)	(64,380)
Accumulated other comprehensive income	590	612
Stockholders' equity	48,843	47,961
Total liabilities and stockholders' equity	$ 55,806	$ 55,798

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

ALLIANCE FIBER OPTIC PRODUCTS, INC.
Condensed Consolidated Statements of Operations
(Unaudited, in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues	$ 7,723	$ 10,323	$ 15,366	$ 19,724
Cost of revenues	5,322	7,069	10,667	13,524
Gross profit	2,401	3,254	4,699	6,200
Operating expenses:				
Research and development	762	895	1,491	1,793
Sales and marketing	577	645	1,211	1,313
General and administrative	770	893	1,615	1,787
Total operating expenses	2,109	2,433	4,317	4,893
Income from operations	292	821	382	1,307
Interest and other income, net	172	281	394	677

Net income before tax	$ 464	$ 1,102	$ 776	$ 1,984
Income tax	32	21	42	83
Net income	$ 432	$ 1,081	$ 734	$ 1,901
Net income per share:				
Basic	$ 0.01	$ 0.03	$ 0.02	$ 0.05
Diluted	$ 0.01	$ 0.03	$ 0.02	$ 0.04
Shares used in computing net income per share:				
Basic	41,979	41,574	41,926	41,483
Diluted	42,115	42,674	41,969	42,659

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

ALLIANCE FIBER OPTIC PRODUCTS, INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited, in thousands)

	Six Months Ended June 30, 2009	2008
Cash flows from operating activities:		
Net income	$ 734	$ 1,901
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	533	529
Loss on disposal of property and equipment	4	-
Amortization of stock-based compensation	50	97
Provision for inventory	(85)	(370)
Changes in assets and liabilities:		
Accounts receivable, net	(353)	(1,267)
Inventories	883	(617)
Prepaid expenses and other assets	(215)	(31)
Accounts payable	(567)	864
Accrued expenses	(241)	(215)
Other assets	1	(23)
Other long-term liabilities	3	50
Net cash provided by operating activities	747	918
Cash flows from investing activities:		
Purchase of short-term investments	(5,799)	(13,349)
Proceeds from sales and maturities of short-term investments	573	23,780
Purchase of of property and equipment	(278)	(470)
Net cash provided by (used in) investing activities	(5,504)	9,961
Cash flows from financing activities:		
Proceeds from issurance of stock under ESPP	118	207
Proceeds from the exercise of common stock options	3	133
Repayment of bank borrowings	(74)	(75)
Net cash provided by financing activities	47	265
Effect of exchange rate changes on cash and cash equivalents	(127)	218
Net increase (desrease) in cash and cash equivalents	(4,837)	11,362
Cash and cash equivalents at beginning of period	12,185	4,945
Cash and cash equivalents at end of period	$ 7,348	$ 16,307
Supplemental disclosure of cash flow information:		
Unrealized (loss) gain on investments	$ 46	$ (947)
Cash paid for income taxes	$ -	$ (50)

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Significant Accounting Policies

The Company

Alliance Fiber Optic Products, Inc. (the "Company") was incorporated in California on December 12, 1995 and reincorporated in Delaware on October 19, 2000. The Company designs, manufactures and markets fiber optic components for communications equipment manufacturers. The Company's headquarters are located in Sunnyvale, California, and it has operations in Taiwan and China.

Basis of presentation

The accompanying condensed consolidated balance sheet as of December 31, 2008, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements as of June 30, 2009 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") and include the accounts of Alliance Fiber Optic Products, Inc. and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted pursuant to such rules and regulations.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 and filed with the SEC on March 20, 2009. The unaudited condensed consolidated financial statements as of June 30, 2009, and for the three and six months ended June 30, 2009 and 2008, reflect, in the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the financial information set forth herein. The results of operations for the interim periods are not necessarily indicative of the results to be expected for any subsequent interim period or for an entire year. The December 31, 2008 balance sheet was derived from audited financial statements at that date, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

There have been no significant changes in the Company's critical accounting policies during the six months ended June 30, 2009 as compared to what was previously disclosed in the Company's Form 10-K for the fiscal year ended December 31, 2008 as filed with the SEC on March 20, 2009.

Revenue Recognition

The Company recognizes revenue upon shipment of its products to its customers, provided that the Company has received a purchase order, the price is fixed, collection of the resulting receivable is reasonably assured and transfer of title and risk of loss has occurred. Subsequent to the sale of its products, the Company has no obligation to provide any modification or customization upgrades, enhancements or post contract customer support.

Allowances are provided for estimated returns. A provision for estimated sales return allowances is recorded at the time revenue is recognized based on historical returns, current economic trends and changes in customer demand. Such allowances are adjusted periodically to reflect actual and anticipated experience. Such adjustments, which are recorded against revenue in the period, could be material.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents consist primarily of money market accounts, corporate bonds, and certificates of deposit that are stated at cost, which approximates fair value.

Concentrations of Risk

Our connectivity products (formerly named optical path multiplexing solution) contributed 58.3% and 65.3% of our revenues for the three months ended June 30, 2009 and 2008, respectively. Our optical passive products (formerly named dense wavelength division multiplexing) contributed 41.7% and 34.7% of our revenues for the three months ended June 30, 2009 and 2008, respectively. Our connectivity products contributed 57.3% and 64.2% of our revenues for the six months ended June 30, 2009 and 2008, respectively. Our optical passive products contributed 42.7% and 35.8% of our revenues for the six months ended June 30, 2009 and 2008, respectively.

In the quarters ended June 30, 2009 and 2008, our top 10 customers comprised 64.6% and 67.6% of our revenues, respectively. For the quarter ended June 30, 2009, two customers accounted for 17.5% and 17.2% of our total revenues, respectively. For the quarter ended June 30, 2008, two customers accounted for 18.0% and 10.9% of our total revenues, respectively.

In the six months ended June 30, 2009 and 2008, our top 10 customers comprised 66.6% and 66.0% of our revenues, respectively. For the six months ended June 30, 2009, two customers each accounted for 19.1 % of our total revenues. For the six months ended June 30, 2008, two customers accounted for 19.2% and 10.0% of our total revenues, respectively.

2. Recent Accounting Pronouncements

In April, 2009, the Financial Accounting Standards Board ("FASB") Staff issued amendments to FASB Statement No. 107, "Disclosure about Fair Value of Financial Instruments" and amendments to APB Opinion No. 28 "Interim Financial Reporting" ("FSP FAS 107-1 and APB 28-1"), which are effective for interim reporting periods ending after June 15, 2009. FAS 107-1 and APB 28-1 were issued to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. They also require disclosures in summarized financial information to be reported at interim periods. The adoption of FSP FAS 107-1 and APB 28-1 did not have an impact on the Company's financial statements or results of operations.

In April, 2009, the FASB Staff issued additional guidance for estimating fair value in accordance with FASB Statement No. 157, "Fair Value Measurements" when the volume and level of activity for the asset or liability have significantly decreased ("FSP FAS 157-4"), which is effective for interim reporting periods ending after June 15, 2009. FSP FAS 157-4 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The adoption of FSP FAS 157-4 did not have an impact on the Company's financial statements or results of operations.

In May 2009, the FASB issued FASB Statement No. 165, "Subsequent Events" ("FAS 165"). FAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. FAS 165, which includes a new required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009. The adoption of FAS 165 did not have an impact on the Company's financial statements or results of operations.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), which is effective for us beginning January 1, 2010. This Statement amends FIN 46(R), Consolidation of Variable Interest Entities an interpretation of ARB No. 51, to require revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. We do not believe the adoption of this pronouncement will have a material impact on our financial statements.

In June, 2009, the FASB Staff issued FASB Statement No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FAS Statement No. 162" ("FAS 168"), which is effective July 1, 2009 and will apply to all interim periods ending after September 15, 2009. FAS 168 establishes the FASB Accounting Standards Codification (the "Codification") as the single source of authoritative U.S. accounting and reporting standards applicable for all non-governmental entities, with the exception of guidance issued by the SEC and its staff. FAS 168 will amend the Company's disclosure for references to accounting guidance to include reference to the applicable section of the Codification.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Public Accountants ("AICPA") and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

3. Stock-based Compensation

Effective January 1, 2006, the Company adopted the provisions of FASB Statement No. 123 (revised 2004), "Share-Based Payment" and Securities and Exchange Commission Staff Accounting Bulletin No. 107 (collectively, "Statement No. 123(R)"), which establish accounting for share-based payment ("SBP") awards exchanged for employee services and requires companies to expense the estimated fair value of these awards over the requisite employee service period.

Statement No. 123(R) requires companies to record compensation expense for stock options measured at fair value, on the date of grant, using an option-pricing model. The fair value of stock options is determined using the Binomial Lattice Model instead of the Black-Scholes Model previously utilized under Statement No. 123. The Company believes that the revised model represents a more likely projection of actual outcomes.

Statement No. 123(R) requires that the realized tax benefit related to the excess of the deductible amount over the compensation expense recognized be reported as a financing cash flow rather than as an operating cash flow, as required under previous accounting guidance. The Company does not recognize any tax benefit related to this based on the Company's historical operating performance, lack of taxable income and the accumulated deficit.

As of June 30, 2009, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's option plans.

For the three and six months ended June 30, 2009, the fair value of SBP awards were estimated using the Binomial Lattice valuation model, with the following weighted-average assumptions and fair values as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Volatility (percent)*	35.5	36.4	35.5	36.4
Expected term (in years)**	4	4	4	4
Risk free interest rate (percent)***	1.73	3.02	1.65	2.65
Expected dividend rate (percent)	-	-	-	-
Forfeiture rate (percent)****	10	10	10	10
Weighted-average fair value per option granted	-	N/A	$ -	$ 1.81

* Volatility is projected using Industry Analysts' forecasts for earnings, earning per share, and stock price, and the Company's earning forecast.

** The expected term represents the weighted average period the option is expected to be outstanding and is based primarily on the historical exercise behavior of employees.

*** The risk-free interest rate is based on the U.S. Treasury zero-coupon yield with a maturity that approximates the expected life of the option.

**** Forfeiture rate is the estimated percentage of options forfeited by employees by leaving or being terminated before vesting.

N/A: No options were granted during the three months ended June 30, 2008.

At June 30, 2009, the Company had two stock-based compensation plans. They are: (a) 1997 Stock Option Plan and (b) 2000 Stock Incentive Plan, which are described below.

(a) 1997 Stock Option Plan

In May 1997, the Company adopted its 1997 Stock Plan under which 3,000,000 shares of common stock were reserved for issuance to eligible employees, directors and consultants upon exercise of stock options and stock purchase rights. During the year ended December 31, 2000, an additional 5,200,000 shares were reserved for issuance under the 1997 Stock Plan. Incentive stock options are granted at a price not less than 100% of the fair market value of the Company's common stock and at a price of not less than 110% of the fair market value for grants to any person who owned more than 10% of the voting power of all classes of stock on the date of grant. Nonstatutory stock options are granted at a price not less than 85% of the fair market value of the common stock and at a price not less than 110% of the fair market value for grants to a person who owned more than 10% of the voting power of all classes of stock on the date of the grant. Options granted under the 1997 Stock Plan generally vest over four years and are exercisable for not more than ten years (five years for grants to any person who owned more than 10% of the voting power of all classes of stock on the date of the grant). In November 2000, the 1997 Stock Plan was replaced by the 2000 Stock Incentive Plan.

(b) 2000 Stock Incentive Plan

In November 2000, the Company adopted its 2000 Stock Incentive Plan under which 1,500,000 shares of common stock were reserved for issuance to eligible employees, directors and consultants upon exercise of stock options and stock purchase rights. On January 1 of each year, beginning on January 1, 2001, the number of shares available for grant will automatically increase by the lesser of: (i) 1,700,000 shares; (ii) 5% of the fully diluted outstanding shares of stock on that date; or (iii) a lesser amount as may be determined by the Board of Directors. The Board of Directors determined not to increase the number of shares available under the Plan on January 1, 2009 and 2008, respectively. Incentive stock options and nonstatutory stock options are granted at 100% of the fair market value of the Company's common stock on the date of grant.

Options granted under the 2000 Stock Incentive Plan generally vest over four years. However, most options granted in the past three years have been fully vested at the time of grant. Options are exercisable for not more than ten years.

The following information relates to the stock option activity for the six months ended June 30, 2009:

Options			**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life**		**Aggregate Intrinstc Value**
Outstanding at December 31, 2008	4,856,083	$	1.40			
Granted	30,000		0.88			
Exercised	(3,000)		0.96			
Forfeited	(12,500)		1.31			
Outstanding at June 30, 2009	4,870,583	$	1.39	5.27 Years	$	544,947
Vested and expected to vest at June 30, 2009	4,844,416	$	1.39	5.26 Years	$	542,596
Exercisable at June 30, 2009	4,670,173	$	1.39	5.16 Years	$	526,356

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the second quarter of fiscal 2009 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2009. This amount changes based on the fair market value of the Company's stock. The total intrinsic value of options exercised for the three and six months ended June 30, 2009 was de minimis.

The Company granted 30,000 options to purchase common stock to one of the members of the Board of Directors during the quarter ended June 30, 2009. The option vests as to one thirty-sixth of the shares on the grant date and an additional one thirty-sixth of the shares vest on the first day of each full month thereafter. The weighted average grant date fair value of options granted during the quarter ended June 30, 2009 was de minimis.

Expected dividend rate is 0% for both three month periods ended June 30, 2009 and 2008 respectively.

Cash received from option exercises during the three and six months ended June 30, 2009 was $2,880, and is included within the financing activities section in the accompanying consolidated statements of cash flows.

The following table summarizes employee stock-based compensation expense resulting from stock options and employee stock purchase plan (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Included in cost of revenue:	$ 11	$ 20	$ 25	$ 42
Included in operating expenses:				
Research and development	5	9	11	19
Sales and marketing	2	6	6	13
General and administrative	4	11	8	23
Total	11	26	25	55
Total stock-based compensation expense	$ 22	$ 46	$ 50	$ 97

4. Inventories, net (in thousands)

	June 30, 2009 (unaudited)	December 31, 2008
Inventories		
Finished goods	$ 1,619	$ 1,880
Work-in-process	1,434	1,393
Raw materials	1,763	2,341
	$ 4,816	$ 5,614

5. Net Income Per Share

Basic net income per share is computed by dividing net income for the period by the weighted average number of shares of common stock outstanding during the period. Diluted net income per share is computed using the weighted-average number of shares of common stock outstanding plus the effect of all in-the-money dilutive options representing potential shares of common stock outstanding during the period.

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	$ 432	$ 1,081	$ 743	$ 1,901
Weighted-average common shares - basic	41,979	41,574	41,926	41,483
Dilutive effect of employee stock option plan	136	1,100	43	1,176
Weighted-average common shares outstanding - diluted	42,115	42,674	41,969	42,659
Basic earnings per common share	$ 0.01	$ 0.03	$ 0.02	$ 0.05
Diluted earnings per common share	$ 0.01	$ 0.03	$ 0.02	$ 0.04

For the three and six months ended June 30, 2009, 4.7 million and 4.8 million outstanding weighted average stock options were excluded from the calculation of diluted earnings per common share. For the three and six months ended June 30, 2008, 2.0 million and 0.2 million outstanding weighted average stock options were excluded from the calculation of diluted earnings per common share. The Company excluded these stock options because their exercise prices were greater than the average market value of the common shares. These options could be included in the calculation in the future if the average market value of the common shares increases and is greater than the exercise price of these options.

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6. Comprehensive Income

Comprehensive income is defined as the change in equity of a company during a period resulting from transactions and other events and circumstances, excluding transactions resulting from investments by owners and distributions to owners. The difference between net income and comprehensive income for the Company is due to foreign exchange translations adjustments and unrealized gain (loss) on available-for-sale securities.

The components of comprehensive income are as follows (in thousands):

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Net income	$ 432	$ 1,081	$ 734	$ 1,901
Cumulative translation adjustments	113	143	(69)	521
Unrealized gain (loss) on short-term investments	212	(227)	47	(947)
Total comprehensive income	$ 757	$ 997	$ 712	$ 1,475

7. Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* on January 1, 2007. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company has determined the impact of the adoption of FIN 48 is insignificant to the Company's consolidated financial position, results of operations and cash flows.

8. Commitments and Contingencies

Litigation:

From time to time, the Company may be involved in litigation in the normal course of business. As of the date of these financial statements, the Company is not aware of any material legal proceedings pending or threatened against the Company.

Indemnification and Product Warranty:

The Company indemnifies certain customers, suppliers and subcontractors for attorney fees and damages and costs awarded against these parties in certain circumstances in which products are alleged to infringe third party intellectual property rights, including patents, trade secrets, trademarks or copyrights. In all cases, there are limits on and exceptions to the potential liability for indemnification relating to intellectual property infringement claims. The Company cannot estimate the amount of potential future payments, if any, that it might be required to make as a result of these agreements. As of the date of this Report, the Company has not paid any claim or been required to defend any action related to indemnification obligations, and accordingly, the Company has not accrued any amounts for such indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations.

The Company generally warrants products against defects in materials and workmanship and non-conformance to specifications for varying lengths of time. If there is a material increase in customer claims compared with historical experience, or if costs of servicing warranty claims are greater than expected, the Company may record a charge against cost of revenues.

Operating Leases:

The Company leases office space under long-term operating leases expiring at various dates through 2014.

The Company's aggregate future minimum facility lease payments are as follows (in thousands):

Six months ending December 31, 2009	$	428
Years ending December 31:		
2010		672
2011		203
2012		154
2013		152
2014		127
Total	$	1,736

Letter of Credit:

The Company had a letter of credit of $0.4 million which expired on April 12, 2009.

9. Bank Loans

In November 2004, the Company entered into a ten-year loan of $0.5 million in Taiwan with an interest rate of 2.3% for the first two years and 3.6% for the following years. In November 2006, the Company entered into a seven-year loan of $0.2 million in Taiwan with an interest rate of 2.8%. Both loans are secured by the Company's building in Taiwan. The net book value of the building was $0.6 million as of June 30, 2009.

In April 2005, the Company entered into a five-year equipment loan of $0.2 million in Taiwan with an interest rate of 2.9% for the first year and 3.7% for the following years. In September 2007, the Company entered into a three-year equipment loan of $0.04 million and a five-year equipment loan of $0.1 million with an interest rate of 3.68% for the first year for both loans.

Payments due under our bank loans as of June 30, 2009 were as follows (in thousands):

Years ending December 31,		
2009	$	74
2010		120
2011		99
2012		92
2013		73
2014 and after		47
Total payment		505
Less: Amounts representing interest		(24)
Present value of net remaining payments		481
Less: current portion		(132)
Long-term portion	$	349

10. Related Party Transactions

As of June 30, 2009, Foxconn Holding Limited was a holder of 18.97% of the Company's common stock, based on share ownership information set forth in a Schedule 13G filed by Foxconn Holding Limited on January 4, 2002. The Company sells products and purchases raw materials from Hon Hai Precision Industry Company Limited, who is the parent company of Foxconn Holding Limited, in the normal course of business. These transactions were made at prices and terms consistent with those with unrelated third parties. There were no sales of products to Hon Hai Precision Industry Company Limited for the three months ended June 30, 2009. Sales of products to Hon Hai Precision Industry Company Limited were $0.01 million for the six months ended June 30, 2009. Purchases of raw materials from Hon Hai Precision Company Limited were $0.5 million and $0.9 million for the three and six months ended June 30, 2009, respectively. There were no amounts due from Hon Hai Precision Company Limited at June 30, 2009. Amounts due to Hon Hai Precision Company Limited were $0.5 million at June 30, 2009.

11. Fair Value of Financial instruments

Effective January 1, 2008, the Company adopted SFAS 157. SFAS 157 provides a definition of fair value, establishes a hierarchy for measuring fair value under generally accepted accounting principles, and requires certain disclosures about fair values used in the financial statements. SFAS 157 does not extend the use of fair value beyond what is currently required by other pronouncements, and it does not pertain to stock-based compensation under SFAS No. 123R, *Share-Based Payments* ("SFAS 123R") or to leases under SFAS No. 13, *Accounting for Leases* .

In February 2008, FASB Staff Position ("FSP") FAS 157-2, *Effective Date of FASB Statement No. 157* , was issued. This FSP provides a one year deferral of the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, the Company has adopted the provisions of SFAS 157 with respect to financial assets and liabilities only.

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company measures the following financial assets at fair value on a recurring basis. The fair value of these financial assets at June 30, 2009 (in thousands) are as follows:

	Fair value Measurements at Reporting Data Using			
	Balance at June 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 3,999	$ 3,999	$ -	$ -
Short-term investments	31,622	17,190	-	14,432
Other current assets - Rights	1,793	-	-	1,793
Total	$ 37,414	$ 21,189	$ -	$ 16,225

As of June 30, 2009, the Company held investments in corporate bonds, agencies (Federal Home Loan Mortgage Corporation), certificates of deposit, money market securities, and ARS. The Company's cash and cash equivalents are comprised of investments of 90 days or less from the date of purchase and these investment instruments are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company's short-term investments are comprised of corporate bonds and agencies of 91 days or more from the date of purchase. These investment instruments are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets.

As of June 30, 2009, the Company held investments in auction rate securities ("ARS") that are required to be measured at fair value on a recurring basis. Since February 2008, all ARS investments in the Company's portfolio have experienced failed auctions. Due to the lack of liquidity, the Company reclassified its ARS portfolio from short-term available-for-sale to long-term available-for-sale investment securities as of March 31, 2008. The Company's ARS investments have been classified within Level 3 as their valuation requires substantial judgment and estimation of factors that are not currently observable in the market due to the lack of trading. This valuation may be revised in future periods as market conditions evolve. The Company estimated the fair value of its ARS based on estimates contained in broker statements that were compiled utilizing Level 3 inputs including, but not limited to factors such as tax status, credit quality, duration, insurance wraps and the portfolio composition of The Federal Family Education Loan Program loans.

On June 8, 2009 and June 23, 2009, the Pennsylvania Higher Education completed a partial call of the ARS at par and the Company received settlement of $50,000 and $25,000, respectively. On June 30, 2009, the Company reclassified the ARS and the related Right (as defined below) from long-term investments to short-term investments and current other assets.

In November 2008, the Company accepted an offer from UBS, the Company's investment advisor, granting the Company the right to require UBS to purchase the Company's ARS at their par value of $16.3 million anytime during the two-year period beginning June 30, 2010 ("Right"). UBS has also established a program which allows the Company to establish a no net cost line of credit and borrow up to 75 percent of the market value of the ARS at interest rates equal to the return the Company would receive on the underlying ARS securities. Management reviewed the UBS offer, credit rating, and financial stability and believed that UBS will purchase the Company's ARS at par value beginning on June 30, 2010. The Right represents an instrument by which the Company may require UBS to repurchase its ARS at par value. The Company has valued the Right as the difference between the par value and the fair value of its ARS as adjusted for any bearer risk associated with UBS' financial ability to repurchase the Company's ARS beginning on June 30, 2010. Upon election for fair value option for the Right under FAS 159, the Company will continue to measure the value of the Right at the difference between par value and fair value in subsequent periods.

In conjunction with the adoption of FAS 159, the Company elected the fair value option for its ARS and the Right. Since the Right is directly related to the Company's ARS investments, the Company elected the fair value option for these financial assets and they have been classified within Level 3 as ARS investments. In conjunction with the adoption of FAS 159, the Company elected a one-time transfer of ARS subject to settlements from available-for-sale to the trading category. As of June 30, 2009, the Company has recognized the Right as other assets on the balance sheet and recorded a gain of $0.8 million as other income.

The following table provides a reconciliation of the beginning and ending balance for the assets measured at fair value using significant unobservable inputs (Level 3) (in thousands):

	Significant Unobservable Inputs (Level 3)
Fair value December 31, 2008	$ 16,300
Gain on Short-term investments	788
Loss on other assets	(788)
Sale on short-term investments	(75)
Fair value June 30, 2009	$ 16,225

1 2 . Geographic Segment Information

The Company operates in a single industry segment. This industry segment is characterized by rapid technological change and significant competition.

The following is a summary of the Company's revenues generated by geographic segments, revenues generated by product lines and identifiable assets located in these segments (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenues				
North America	$ 3,558	$ 5,771	$ 6,573	$ 10,705
Europe	1,958	1,543	4,219	2,619
Asia	2,207	3,009	4,574	6,400
	$ 7,723	$ 10,323	$ 15,366	$ 19,724

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenues				
Connectivity products	$ 4,504	$ 6,736	$ 8,811	$ 12,671
Optical passive products	3,219	3,587	6,555	7,053
	$ 7,723	$ 10,323	$ 15,366	$ 19,724

	Jun 30, 2009	Dec 31, 2008
	(unaudited)	
Property and Equipment		
United States	$ 107	$ 133
Taiwan	2,538	2,793
China	1,737	1,727
Total	$ 4,382	$ 4,653

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

When used in this Report, the words "expects," "anticipates," "believes", "estimates," "plans," "intends," "could," "will," "may" and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include statements as to our operating results, revenues, sources of revenues, cost of revenues, gross profit, profitability, the amount and mix of anticipated investments, expenditures and expenses, our liquidity and the adequacy of our capital resources, our ARS and associated Rights, exposure to interest rate or currency fluctuations, anticipated working capital and capital expenditures, reliance on our connectivity products, our cash flow, trends in average selling prices, our reliance on the commercial success of our optical passive products, plans for future products and enhancements of existing products, features, benefits and uses of our products, demand for our products, our success being tied to relationships with key customers, industry trends and market demand, our efforts to protect our intellectual property, the potential benefit of indemnification agreements, increases in the number of possible license offers and patent infringement claims, our competitive position, sources of competition, consolidation in our industry, our international strategy, inventory management, our employee relations, the adequacy of our internal controls, and the effect of recent, future and changing accounting pronouncements and our critical accounting policies, estimates, models and assumptions on our financial results. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, those risks discussed elsewhere in this report, as well as risks related to the development of the metropolitan, last mile access, and enterprise networks, customer acceptance of our products, our ability to retain and obtain customers, industry-wide overcapacity and shifts in supply and demand for optical components and modules, our ability to meet customer demand and manage inventory, fluctuations in demand for our products, declines in average selling prices, development of new products by us and our competitors, increased competition, inability to obtain sufficient quantities of a raw material component, loss of a key supplier, integration of acquired businesses or technologies, financial stability in foreign markets, foreign currency exchange rates, interest rates, costs associated with being a public company, failure to remain listed on the Nasdaq Capital Market, failure to meet customer requirements, our ability to license intellectual property on commercially reasonable terms, economic stability, and the risks set forth below under Part II, Item 1A, "Risk Factors." These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based *.*

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K, its Consolidated Financial Statement and the notes thereto, for the year ended December 31, 2008.

The following discussion should be read in conjunction with our Condensed Consolidated Financial Statements and Notes thereto.

Critical Accounting Policies and Estimates

Stock-based Compensation Expense

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors including employee stock options and employee stock purchases pursuant to our Employee Stock Purchase Plan ("ESPP") based on estimated fair values. We adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our 2006 fiscal year.

Stock-based compensation expense recognized under SFAS 123(R) for the three and six months ended June 30, 2009 was $0.02 million and $0.05 million, respectively, determined by the Binomial Lattice valuation model, and represents stock-based compensation expense related to our employee stock purchase plan. As of June 30, 2009, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements under the Company's stock option plan.

Management's discussion and analysis of financial condition and results of operations is based on 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 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 revenue recognition, bad debts, inventories, asset impairments, income taxes, contingencies, and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values for assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

For additional information regarding our critical accounting policies and estimates, see the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2008.

Overview

We were founded in December 1995 and commenced operations to design, manufacture and market fiber optic interconnect products, which we call our connectivity products. We started selling our optical passive products in July 2000. Since introduction, sales of optical passive products have fluctuated with the overall market for these products.

Our connectivity products contributed revenues of $4.5 million and $6.7 million for the three months ended June 30, 2009 and 2008, respectively. Our optical passive products contributed revenues of $3.2 million and $3.6 million for the three months ended June 30, 2009 and 2008, respectively. Our connectivity products contributed 57.3% and 64.2% of our revenues for the six months ended June 30, 2009 and 2008, respectively. Our optical passive products contributed 42.7% and 35.8% of our revenues for the six months ended June 30, 2009 and 2008, respectively.

In the three months ended June 30, 2009 and 2008, our top 10 customers comprised 64.6% and 67.6% of our revenues, respectively. For the three months ended June 30, 2009, two customers accounted for 17.5% and 17.2% of our total revenues. For the three months ended June 30, 2008, two customers accounted for 18.0% and 10.9% of our total revenues. We market and sell our products predominantly through our direct sales force.

In the six months ended June 30, 2009 and 2008, our top 10 customers comprised 66.6% and 66.0% of our revenues, respectively. For the six months ended June 30, 2009, two customers each accounted for 19.1% of our total revenues. For the six months ended June 30, 2008, two customers accounted for 19.2% and 10.0% of our total revenues, respectively.

Our cost of revenues consists of raw materials, components, direct labor, manufacturing overhead and production start-up costs. We expect that our cost of revenues as a percentage of revenues will fluctuate from period to period based on a number of factors including:

- changes in manufacturing volume;
- costs incurred in establishing additional manufacturing lines and facilities;
- inventory write-downs and impairment charges related to manufacturing assets;
- mix of products sold;
- changes in our pricing and pricing from our competitors;
- mix of sales channels through which our products are sold; and
- mix of domestic and international sales.

Research and development expenses consist primarily of salaries and related personnel expenses, fees paid to outside service providers, materials costs, test units, facilities, overhead and other expenses related to the design, development, testing and enhancement of our products. We expense our research and development costs as they are incurred. We believe that a significant level of investment for product research and development is required to remain competitive.

Sales and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing, sales and technical support functions, as well as costs associated with trade shows, promotional activities and travel expenses. We intend to continue to invest in our sales and marketing efforts, both domestically and internationally, in order to increase market awareness and to generate sales of our products. However, we cannot be certain that our expenditures will result in higher revenues. In addition, we believe that our future success depends upon establishing successful relationships with a variety of key customers.

General and administrative expenses consist primarily of salaries and related expenses for executive, finance, administrative, accounting and human resources personnel, insurance and professional fees for legal and accounting support.

Results of Operations

The following table sets forth the relationship between various components of operations, stated as a percentage of revenues for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	68.9	68.5	69.4	68.6
Gross profit	31.1	31.5	30.6	31.4
Operating expenses				
Research and development	9.8	8.7	9.7	9.1
Sales and marketing	7.5	6.2	7.9	6.7
General and administrative	10.0	8.7	10.5	9.0
Total operating expenses	27.3	23.6	28.1	24.8
Income from operations	3.8	7.9	2.5	6.6
Interest and other income, net	2.2	2.7	2.6	3.4
Net income	6.0%	10.6%	5.1%	10.0%

Revenues. Revenues were $7.7 million and $10.3 million for the three months ended June 30, 2009 and 2008, respectively. Revenues decreased 25.2% in the three months ended June 30, 2009 from the same period in 2008. Revenues were $15.4 million and $19.7 million for the six months ended June 30, 2009 and 2008, respectively. Revenues decreased 22.1% in the six months ended June 30, 2009 from the same period in 2008. The decrease for the three and six months ended June 30, 2009 was mainly due to reduced orders from our customers as a result of an industry wide slow down due to macro economic conditions. Declines in average selling prices were a secondary cause of the decrease in revenues and resulted from pricing pressure from customers, competitive pricing by other suppliers and general product maturity. We expect we may experience similar levels of average selling prices decline in the future.

Cost of Revenues. Cost of revenues was $5.3 million and $7.1 million for the three months ended June 30, 2009 and 2008, respectively. Cost of revenues as a percentage of revenues increased to 68.9% for the three months ended June 30, 2009 from 68.5% for the three months ended June 30, 2008. Cost of revenues was $10.7 million and $13.5 million for the six months ended June 30, 2009 and 2008, respectively. Cost of revenues as a percentage of revenues increased to 69.4% for the six months ended June 30, 2009 from 68.6% for the six months ended June 30, 2008. The higher cost of revenues as a percentage of revenues for the period ended June 30, 2009 was due to the lower sales of connectivity products, which have higher gross margins.

Gross Profit. Gross profit decreased in dollars to $2.4 million, or 31.1% of revenues, for the three months ended June 30, 2009 from $3.3 million, or 31.5% of revenues, for the same period in 2008. Gross profit decreased to $4.7 million, or 30.6% of revenues, for the six months ended June 30, 2009 from $6.2 million, or 31.4% of revenues, for the same period in 2008. For the three and six months ended June 30, 2009, the lower gross profit was due to the lower utilization of our factories as a result of decreased volume shipments to our customers. Declines in average selling prices were offset by cost improvements other than utilization, including material purchase prices and yield and cycle time improvements.

Research and Development Expenses . Research and development expenses decreased to $0.8 million for the three months ended June 30, 2009 from $0.9 million for the same period in 2008. Research and development expenses decreased to $1.5 million for the six months ended June 30, 2009 from $1.8 million for the same period in 2008. The decrease was primarily due to costs control and fewer products in development.

As a percentage of revenues, research and development expenses increased to 9.8% in the three months ended June 30, 2009 from 8.7% for the same period in 2008. As a percentage of revenues, research and development expenses increased to 9.7% in the six months ended June 30, 2009 from 9.1% for the same period in 2008. The higher research and development expenses as a percentage of revenues was mainly due to decreased revenue levels. We expect research and development expenses on our product development efforts to increase in the near term as we intend to continue to invest in our research and product development efforts.

Sales and Marketing Expenses . Sales and marketing expenses remained at $0.6 million for the three months ended June 30, 2009 and 2008, respectively. Sales and marketing expenses decreased to $1.2 million for the six months ended June 30, 2009 from $1.3 million for the same period in 2008. As a percentage of revenues, sales and marketing expenses increased to 7.5% in the three months ended June 30, 2009 from 6.2% for the same period in 2008.

As a percentage of revenues, sales and marketing expenses increased to 7.9% in the six months ended June 30, 2009 from 6.7% for the same period in 2008. The higher sales and marketing expenses as a percentage of revenues was mainly due to decreased revenue levels. We expect sales and marketing expenses will remain relatively flat in the next two quarters.

General and Administrative Expenses . General and administrative expenses decreased to $0.8 million for the three months ended June 30, 2009 from $0.9 million for the same period in 2008. General and administrative expenses decreased to $1.6 million for the six months ended June 30, 2009 from $1.8 million for the same period in 2008.

As a percentage of revenues, general and administrative expenses increased to 10.0% in the three months ended June 30, 2009 from 8.7% for the same period in 2008. As a percentage of revenues, general and administrative expenses increased to 10.5% in the six months ended June 30, 2009 from 9.0% for the same period in 2008. The higher general and administrative expenses as a percentage of revenue was mainly due to decreased revenue levels. We expect general and administrative expenses will increase due to higher fees and costs associated with compliance with laws and regulations such as the Sarbanes-Oxley Act of 2002 and the regulations promulgated thereunder.

Stock-Based Compensation . Total stock-based compensation decreased to $22,000 for the three months ended June 30, 2009 from $46,000 for the same period in 2008. Total stock-based compensation decreased to $50,000 for the six months ended June 30, 2009 from $97,000 for the same period in 2008. These decreases were because the majority of options granted in the past three years were fully vested at the time of grant.

Interest and Other Income, Net. Interest and other income, net, was $0.2 million and $0.3 million for the three months ended June 30, 2009 and 2008, respectively. Interest and other income, net, was $0.4 million and $0.7 million for the six months ended June 30, 2009 and 2008, respectively.

Income Tax Expense. Income tax expense was approximately $0.03 million and $0.02 million for the three months ended June 30, 2009 and 2008, respectively. Income tax expense was approximately $0.04 million and $0.08 million for the six months ended June 30, 2009 and 2008, respectively. During the first quarter of 2008, we paid $0.05 million income tax for the year ended December 31, 2007.

Liquidity and Capital Resources

At June 30, 2009, we had cash and cash equivalents of $7.3 million and short-term investments of $31.6 million, which includes our ARS of $14.4 million. We also hold $1.8 million of ARS Rights in other current assets. On June 30, 2009, we reclassified $16.2 million of ARS and the related ARS Right from long-term to current assets. The ARS and associated Rights are not saleable by us at the date hereof. Accordingly, we do not consider the ARS or the Rights as sources of liquidity at this time.

Net cash provided by operating activities was $0.7 million for the six months ended June 30, 2009. The increase in net cash provided by operating activities was primarily due to net income of $0.7 million. Additionally, cash used for accounts payable of $0.6 million, accounts receivable of $0.4 million, prepaid expenses of $0.2 million, and accrued liabilities of $0.2 million, offset cash provided by decreases in inventory of $0.9 million, and depreciation and amortization of $0.5 million.

Net cash provided by operating activities was $0.9 million for the six months ended June 30, 2008. Net cash provided by operating activities was primarily due to net income of $1.9 million, an increase in accounts payable of $0.9 million, and total depreciation and amortization expenses of $0.6 million, which was offset by a $1.3 million increase in accounts receivable, a $0.4 million decrease in inventory provision and a $0.6 million increase in inventory.

Cash used in investing activities was $5.5 million for the six months ended June 30, 2009. This resulted from $5.2 million in net purchases of short-term investments and reclassification of long-term investments to short-term investments. We also used $0.3 million cash on equipment purchases. Cash provided by investing activities was $10.0 million for the six months ended June 30, 2008. This resulted from $10.4 million in net proceeds from sales of short-term investments offset by $0.5 million spending on equipment purchases.

Cash provided by financing activities was $0.05 million and $0.3 for the six months ended June 30, 2009 and 2008, respectively, and was comprised of proceeds from the exercise of options to purchase our common stock and the sale of our common stock through our Employee Stock Purchase Plan. Cash used in financing activities was $0.08 million each for the six months ended June 30, 2009 and 2008, respectively, and was used for repayment of bank borrowings.

We believe that our current cash, cash equivalents and short-term investments will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. However, our future growth, including any potential acquisitions, may require additional funding. If cash generated from operations is insufficient to satisfy our long-term liquidity requirements, we may need to raise capital through additional equity or debt financings, additional credit facilities, strategic relationships or other arrangements. If additional funds are raised through the issuance of securities, these securities could have rights, preferences and privileges senior to holders of common stock, and the terms of any debt facility could impose restrictions on our operations. The sale of additional equity or debt securities could result in additional dilution to our stockholders, and additional financing may not be available in amounts or on terms acceptable to us, if at all. If we are unable to obtain additional financing, we may be required to reduce the scope of our planned product development and marketing efforts. Strategic arrangements, if necessary to raise additional funds, may require us to relinquish our rights to certain of our technologies or products. Our failure to raise capital when needed could harm our business, financial condition and operating results.

Contractual Obligations

Our long-term debt obligations are for principal and interest on mortgage and equipment loans from financial institutions in Taiwan.

In July 2004, we moved into our corporate headquarters in Sunnyvale, California. The lease has a six-year term commencing on July 22, 2004.

In Taiwan, we lease a total of approximately 38,800 square feet in one facility located in Tu-Cheng City, Taiwan. This lease expires at various times from May 2010 to December 2011. In December 2000, the Company purchased approximately 8,200 square feet of space immediately adjacent to the leased facility for $0.8 million, bringing the total square footage to approximately 47,000 square feet.

In July 2007, we renewed the lease for our 62,000 square foot facility in the Shenzhen area of China, which will expire in July 2012. In February 2007, we entered into a lease for an 8,200 square feet facility in Shenzhen, which lease will expire in January 2012.

In August 2009, we expanded our facility in the Shenzhen area of China. We replaced the existing two leases with a new lease for a 132,993 square foot facility in Shenzhen, which lease will expire in October 2014.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required.

Recent Accounting Pronouncements

See Note 2 of our Notes to Unaudited Condensed Consolidated Financial Statements included with this Quarterly Report on Form 10-Q for information on recent accounting pronouncements.

ITEM 4T: CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.* We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Acting Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures 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 its stated goals under all potential future conditions. Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Acting Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

(b) *Changes in internal controls.* There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1A: RISK FACTORS

We have a history of losses, may experience future losses and may not be able to generate sufficient revenues in the future to achieve and sustain profitability.

We had net income of approximately $0.4 million and $1.1 million in the second quarter of fiscal 2009 and 2008, respectively. Although we generated a profit in the second quarter of fiscal 2009 and 2008, we may not be able to sustain profitability in the future. Although our cash and cash equivalents increased in the second quarter of fiscal 2009, our cash flows may be negative again in the future as we continue to invest in our business. As of June 30, 2009, we had an accumulated deficit of approximately $63.6 million.

We continue to experience fluctuating demand for our products. If demand for our products increases in the future, we expect to incur significant and increasing expenses for expansion of our manufacturing operations, research and development, sales and marketing, and administration, and in expanding direct sales and distribution channels. Given the rate at which competition in our industry intensifies and the fluctuations in demand for our products, we may not be able to adequately control our costs and expenses or achieve or maintain adequate operating margins. As a result, to maintain profitability, we will need to generate and sustain substantially higher revenues while maintaining reasonable cost and expense levels. We may not be able to sustain profitability on a quarterly or an annual basis.

Our connectivity products have historically represented a significant part of our revenues, and if we are unsuccessful in commercially selling our optical passive products, our business will be seriously harmed.

Sales of our connectivity products accounted for over 58.3% of our revenues in the quarter ended June 30, 2009 and a majority of our historical revenues. We expect to substantially depend on these products for the majority of our near-term revenues. Any significant decline in the price of, or demand for, these products, or failure to increase their market acceptance, would seriously harm our business. In addition, we believe that our future growth and a significant portion of our future revenues will depend on the commercial success of our optical passive products, which we began shipping commercially in July 2000. Demand for these products has fluctuated over the past few years, declining sharply starting in mid fiscal 2001 and then increasing beginning in 2003. If demand for these products does not continue to increase and our target customers do not continue to adopt and purchase our optical passive products, our revenues may decline and we may have to write-off additional inventory that is currently on our books.

Declining general economic or business conditions may have a negative impact on our business.

Concerns over inflation, deflation, energy costs, geopolitical issues, the availability and cost of credit, the Federal stimulus package and budget process, the U.S. mortgage market and a declining real estate market in the U.S. have contributed to increased volatility and diminished expectations for the global economy and expectations of slower global economic growth going forward. These factors, combined with volatile oil prices, declining business and consumer confidence, a declining stock market and increased unemployment, have precipitated an economic slowdown and recession. If the economic climate in the U.S. does not improve or continues to deteriorate, our business, including our customers and our suppliers, could be negatively affected, resulting in a negative impact on our revenues.

We depend on a small number of customers for a significant portion of our total revenues and the loss of, or a significant reduction in orders from, any of these customers, would significantly reduce our revenues and harm our operating results.

In the quarters ended June 30, 2009 and 2008, our top 10 customers comprised 64.6% and 67.6% of our revenues, respectively. Two customers accounted for 17.5% and 17.2% of our total revenues for the three months ended June 30, 2009. Two customers accounted for 19.1% each of our total revenues for the six months ended June 30, 2009.

We derive a significant portion of our revenues from a small number of customers, and we anticipate that we will continue to do so in the foreseeable future. These customers may decide not to purchase our products at all, to purchase fewer products than they did in the past, or to alter their purchasing patterns in some other way. The loss of any significant customer, a significant reduction in sales we make to them, or any problems collecting receivables from them would likely harm our financial condition and results of operations.

Our quarterly and annual financial results have historically fluctuated due primarily to introduction of, demand for, and sales of our products, and future fluctuations may cause our stock price to decline.

We believe that period-to-period comparisons of our operating results are not a good indication of our future performance. Our quarterly operating results have fluctuated in the past and are likely to fluctuate significantly in the future due to a number of factors. For example, the timing and expenses associated with product introductions and establishing additional manufacturing lines and facilities, changes in manufacturing volume, declining average selling prices of our products, the timing and extent of product sales, the mix of domestic and international sales, the mix of sales channels through which our products are sold, the mix of products sold and significant fluctuations in the demand for our products have caused our operating results to fluctuate in the past. Because we incur operating expenses based on anticipated revenue trends, and a high percentage of our expenses are fixed in the short term, any delay in generating or recognizing revenues or any decrease in revenues could significantly harm our quarterly results of operations. Other factors, many of which are more fully discussed in other risk factors, may also cause our results to fluctuate. Many of the factors that may cause our results to fluctuate are outside of our control. If our quarterly or annual operating results do not meet the expectations of investors and securities analysts, the trading price of our common stock could significantly decline.

U ncertainty in the credit markets has and may continue to impact the value and liquidity of our auction-rate securities , or ARS .

Credit concerns in the capital markets have significantly reduced our ability to liquidate $16.2 million in ARS that we classify as current assets on our balance sheet at June 30, 2009. All ARS we hold have failed to sell at auction since February 2008 due to an insufficient number of bidders. In June 2009, one of the issuer of the ARS completed a partial call at par and the Company received settlement of $75 ,000 . In November 2008, we accepted the right to require UBS to repurchase our ARS investment at par value beginning on June 30, 2010, or the Right. We cannot assure you that UBS will have the ability to purchase our ARS at par or at any other price in the future. Accordingly, we may not be able to exercise the Right or liquidate these securities and use the cash to finance our business. In future periods, the estimated fair value of our ARS and the Right could decline based on market conditions, which could result in impairment charges.

If we cannot attract more optical communications equipment manufacturers to purchase our products, we may not be able to increase or sustain our revenues.

Our future success will depend on our ability to migrate existing customers to our new products and our ability to attract additional customers. Some of our present customers are relatively new companies. The growth of our customer base could be adversely affected by:

- customer unwillingness to implement our products;
- any delays or difficulties that we may incur in completing the development and introduction of our planned products or product enhancements;
- the success of our customers;
- excess inventory in the telecommunications industry;
- new product introductions by our competitors;
- any failure of our products to perform as expected; or
- any difficulty we may incur in meeting customers’ delivery requirements or product specifications.

The fluctuations in the economy have affected the telecommunications industry. Telecommunications companies have cut back on their capital expenditure budgets, which has and may continue to further decrease demand for equipment and parts, including our products. This decrease has had and may continue to have an adverse effect on the demand for fiber optic products and negatively impact the growth of our customer base.

We are exposed to risks and increased expenses and business risk as a result of new Restriction on Hazardous Substances, or RoHS directives.

Following the lead of the European Union, or EU, various governmental agencies have either already put into place or are planning to introduce regulations that regulate the permissible levels of hazardous substances in products sold in various regions of the world. For example, the RoHS directive for EU took effect on July 1, 2006. The labeling provisions of similar legislation in China went into effect on March 1, 2007. Consequently, many suppliers of products sold into the EU have required their suppliers to be compliant with the new directive. Many of our customers have adopted this approach and have required our full compliance. Though we have devoted a significant amount of resources and effort planning and executing our RoHS program, it is possible that some of our products might be incompatible with such regulations. In such event, we could experience the following consequences: loss of revenue, damaged reputation, diversion of resources, monetary penalties, and legal action.

The market for fiber optic components is increasingly competitive, and if we are unable to compete successfully our revenues could decline.

The market for fiber optic components is intensely competitive. We believe that our principal competitors are the major manufacturers of optical components and integrated modules, including vendors selling to third parties and business divisions within communications equipment suppliers. Our principal competitors in the components market include Avanex Corp., DiCon Fiberoptics, Inc., JDS Uniphase Corp., Oplink Communications Inc., Stratos International, Inc. and Tyco Electronics Corporation. We believe that we primarily compete with diversified suppliers for the majority of our product line and to a lesser extent with niche companies that offer a more limited product line. Competitors in any portion of our business may also rapidly become competitors in other portions of our business.

Many of our current and potential competitors have significantly greater financial, technical, marketing, purchasing, manufacturing and other resources than we do. As a result, these competitors may be able to respond more quickly to new or emerging technologies and to changes in customer requirements, to devote more resources to the development, promotion and sale of products, to negotiate lower prices on raw materials and components, or to deliver competitive products at lower prices.

Several of our existing and potential customers are also current and potential competitors of ours. These companies may develop or acquire additional competitive products or technologies in the future and subsequently reduce or cease their purchases from us. In light of the consolidation in the optical networking industry, we also believe that the size of suppliers will be an increasingly important part of a purchaser’s decision-making criteria in the future. We may not be able to compete successfully with existing or new competitors, and we cannot ensure that the competitive pressures we face will not result in lower prices for our products, loss of market share, or reduced gross margins, any of which could harm our business.

New and competing technologies are emerging due to increased competition and customer demand. The introduction of products incorporating new or competing technologies or the emergence of new industry standards could make our existing products noncompetitive. For example, there are technologies for the design of wavelength division multiplexers that compete with the technology that we incorporate in our products. If our products do not incorporate technologies demanded by customers, we could lose market share causing our business to suffer.

If we fail to effectively manage our operations, specifically given the past history of sudden and dramatic downturn in demand for our products, our operating results could be harmed.

As of June 30, 2009, we had a total of 41 full-time employees in Sunnyvale, California, 256 full-time employees in Taiwan, and 539 full-time employees in China. Matching the scale of our operations with demand fluctuations, combined with the challenges of expanding and managing geographically dispersed operations, has placed, and will continue to place, a significant strain on our management and resources. To manage the expected fluctuations in our operations and personnel, we will be required to:

- improve existing and implement new operational, financial and management controls, reporting systems and procedures;
- hire, train, motivate and manage additional qualified personnel, especially if we experience a significant increase in demand for our products;
- effectively expand or reduce our manufacturing capacity, attempting to adjust it to customer demand; and
- effectively manage relationships with our customers, suppliers, representatives and other third parties.

In addition, we will need to coordinate our domestic and international operations and establish the necessary infrastructure to implement our international strategy. If we are not able to manage our operations in an efficient and timely manner, our business will be severely harmed.

Our success also depends, to a large degree, on the efficient and uninterrupted operation of our facilities. We have expanded our manufacturing facilities in Taiwan and manufacture many of our products there. Our facility in China also houses a substantial portion of our manufacturing operations. There is significant political tension between Taiwan and China. If there is an outbreak of hostilities between Taiwan and China, our manufacturing operations may be disrupted or we may have to relocate our manufacturing operations. Tensions between Taiwan and China may also affect our facility in China. Relocating a portion of our employees could cause temporary disruptions in our operations and divert management's attention.

Because of the time it takes to develop fiber optic components, we incur substantial expenses for which we may not earn associated revenues.

The development of new or enhanced fiber optic products is a complex and uncertain process. We may experience difficulties in design, manufacturing, marketing and other areas that could delay or prevent the development, introduction or marketing of new products and enhancements. Development costs and expenses are incurred before we generate revenues from sales of products resulting from these efforts. Our total research and development expenses were approximately $0.8 million and $0.9 million for the three months ended June 30, 2009 and 2008, respectively. Our total research and development expenses were approximately $1.5 million and $1.8 million for the six months ended June 30, 2009 and 2008, respectively. We expect that our research and development expense may increase in the second half of 2009 as we intend to continue to invest in our research and product development efforts. Any such increase could have a negative impact on our earnings in future periods.

If we are unable to develop new products and product enhancements that achieve market acceptance, sales of our fiber optic components could decline, which could reduce our revenues.

The communications industry is characterized by continued changing technology, frequent new product introductions, changes in customer requirements, evolving industry standards and, more recently, significant variations in customer demand. Our future success depends on our ability to anticipate market needs and develop products that address those needs. As a result, our products could quickly become obsolete if we fail to predict market needs accurately or develop new products or product enhancements in a timely manner. Our failure to predict market needs accurately or to develop new products or product enhancements in a timely manner will harm market acceptance and sales of our products. If the development or enhancement of these products or any other future products takes longer than we anticipate, or if we are unable to introduce these products to market, our sales will not increase. Even if we are able to develop and commercially introduce them, these new products may not achieve the widespread market acceptance necessary to provide an adequate return on our investment.

Current and future demand for our products depends on the continued growth of the Internet and the communications industry, which is experiencing consolidation, realignment, oversupply of product inventory and fluctuating demand for fiber optic products.

Our future success depends on the continued growth of the Internet as a widely used medium for communications and commerce, and the growth of optical networks to meet the increased demand for capacity to transmit data, or bandwidth. If the Internet does not continue to expand as a medium for communications and commerce, the need to significantly increase bandwidth across networks and the market for fiber optic components may not continue to develop. If this growth does not continue, sales of our products may decline, which would adversely affect our revenues. Our customers have experienced an oversupply of inventory due to fluctuating demand for their products that has resulted in inconsistent demand for our products. Future demand for our products is uncertain and will depend heavily on the continued growth and upgrading of optical networks, especially in the metropolitan, last mile, and enterprise access segments of the networks.

Inconsistent spending by telecommunication companies over the past several years has resulted in fluctuating demand for our products. The rate at which communication service providers and other fiber optic network users have built new fiber optic networks or installed new systems in their existing fiber optic networks has fluctuated in the past and these fluctuations may continue in the future. These fluctuations may result in reduced demand for new or upgraded fiber optic systems that utilize our products and therefore, may result in reduced demand for our products. Declines in the development of new networks and installation of new systems have resulted in the past in a decrease in demand for our products, an increase in our inventory, and erosion in the average selling prices of our products.

The communications industry is experiencing consolidation and realignment, as industry participants seek to capitalize on the rapidly changing competitive landscape developing around the Internet and new communications technologies such as fiber optic networks. As the communications industry consolidates and realigns to accommodate technological and other developments, our customers may consolidate or align with other entities in a manner that results in a decrease in demand for our products.

We are experiencing fluctuations in market demand due to overcapacity in our industry and an economy that is stymied by international terrorism, war and political instability.

The United States economy has experienced and continues to experience significant fluctuations in consumption and demand. During the past several years, telecommunication companies have mostly decreased their spending, which has resulted in excess inventory, overcapacity and a decrease in demand for our products. We may experience further decreases in the demand for our products due to a weak domestic and international economy as the fiber optics industry copes with the effects of oversupply of products, international terrorism, war and political instability. Even if the general economy experiences a recovery, the activity of the United States telecommunications industry may lag behind the recovery of the overall United States economy.

The optical networking component industry has in the past, is now, and may in the future experience declining average selling prices, which could cause our gross margins to decline.

The optical networking component industry has in the past experienced declining average selling prices as a result of increasing competition and greater unit volumes as communication service providers continue to deploy fiber optic networks. We expect that average selling prices may decrease in the future in response to new product and technology introductions by competitors, price pressures from significant customers, greater manufacturing efficiencies achieved through increased automation in the manufacturing process and inventory build-up due to decreased demand. Average selling price declines may contribute to a decline in our gross margins, which could harm our results of operations.

We will not attract new orders for our fiber optic components unless we can deliver sufficient quantities of our products to optical communications equipment manufacturers.

Communications service providers and optical systems manufacturers typically require that suppliers commit to provide specified quantities of products over a given period of time. If we are unable to commit to deliver quantities of our products to satisfy a customer’s anticipated needs, we will lose the order and the opportunity for significant sales to that customer for a lengthy period of time. In addition, we would be unable to fill large orders if we do not have sufficient manufacturing capacity to enable us to commit to provide customers with specified quantities of products. However, if we build our manufacturing capacity and inventory in excess of demand, as we have done in the past, we may produce excess inventory that may have to be reserved or written off.

We depend on a limited number of third parties to supply key materials, components and equipment, such as ferrules, optical filters and lenses, and if we are not able to obtain sufficient quantities of these items at acceptable prices, our ability to fill orders would be limited and our operating results could be harmed.

We depend on third parties to supply the raw materials and components we use to manufacture our products. To be competitive, we must obtain from our suppliers, on a timely basis, sufficient quantities of raw materials and components at acceptable prices. We obtain most of our critical raw materials and components from a single or limited number of suppliers and generally do not have long-term supply contracts with them. As a result, our suppliers could terminate the supply of a particular material or component at any time without penalty. Finding alternative sources may involve significant expense and delay, if these sources can be found at all. One component, GRIN lenses, is only available from one supplier. Difficulties in obtaining raw materials or components in the future may delay or limit our product shipments, which could result in lost orders, increase our costs, reduce our control over quality and delivery schedules and require us to redesign our products. If a supplier became unable or unwilling to continue to manufacture or ship materials or components in required volumes, we would have to identify and qualify an acceptable replacement. A delay or reduction in shipments or any need to identify and qualify replacement suppliers would harm our business.

Because we experience long lead times for materials and components, we may not be able to effectively manage our inventory levels and manufacturing capacity, which could harm our operating results.

Because we experience long lead times for materials and components and are often required to purchase significant amounts of materials and components far in advance of product shipments, we may not effectively manage our inventory levels, which could harm our operating results. Alternatively, if we underestimate our raw material requirements, we may have inadequate inventory, which could result in delays in shipments and loss of customers. If we purchase raw materials and increase production in anticipation of orders that do not materialize or that shift to another quarter, we will, as we have in the past, have to carry or write off excess inventory and our gross margins will decline. Both situations could cause our results of operations to be below the expectations of investors and public market analysts, which could, in turn, cause the price of our common stock to decline. The time our customers require to incorporate our products into their own can vary significantly and generally exceeds several months, which further complicates our planning processes and reduces the predictability of our forecasts. Even if we receive these orders, the additional manufacturing capacity that we add to meet our customer’s requirements may be underutilized in a subsequent quarter.

We are exposed to risks and increased expenses as a result of legislation requiring companies to evaluate internal controls over financial reporting.

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to perform an assessment of our internal controls as of December 31, 2008, and our independent auditors to attest to the effectiveness of our internal controls over financial reporting beginning with our year ending December 31, 2009. We have implemented an ongoing program to perform the system and process evaluation and testing we believe to be necessary to comply with these requirements, however, we cannot assure you that we will be successful in our efforts. We expect to incur increased expenses and to devote additional management resources to Section 404 compliance. In the event that our chief executive officer, acting chief financial officer or independent registered public accounting firm determine that our internal controls over financial reporting are not effective as defined under Section 404, investor perceptions of our company may be negatively affected and this could cause a decline in our stock price.

We depend on key personnel to operate our business effectively in the rapidly changing fiber optic components market, and if we are unable to hire and retain appropriate management and technical personnel, our ability to develop our business could be harmed.

Our success depends to a significant degree upon the continued contributions of the principal members of our technical sales, marketing, engineering and management personnel, many of whom perform important management functions and would be difficult to replace. We particularly depend upon the continued services of our executive officers, particularly Peter Chang, our President and Chief Executive Officer; David Hubbard, our Vice President, Sales and Marketing; Wei-shin Tsay, our senior Vice President of Product Development; Anita Ho, our Acting Chief Financial Officer and Corporate Controller; and other key engineering, sales, marketing, finance, manufacturing and support personnel. In addition, we depend upon the continued services of key management personnel at our Taiwanese subsidiary and at our facility in China. None of our officers or key employees is bound by an employment agreement for any specific term, and may terminate their employment at any time. In addition, we do not have “key person” life insurance policies covering any of our employees.

Our ability to continue to attract and retain highly skilled personnel will be a critical factor in determining whether we will be successful in the future. We may have difficulty hiring skilled engineers at our manufacturing facilities in the United States, Taiwan, and China. If we are not successful in attracting, assimilating or retaining qualified personnel to fulfill our current or future needs, our business may be harmed.

If we are not able to achieve acceptable manufacturing yields and sufficient product reliability in the production of our fiber optic components, we may incur increased costs and delays in shipping products to our customers, which could impair our operating results.

Complex and precise processes are required for the manufacture of our products. Changes in our manufacturing processes or those of our suppliers, or the inadvertent use of defective materials, could significantly reduce our manufacturing yields and product reliability. Because the majority of our manufacturing costs are relatively fixed, manufacturing yields are critical to our results of operations. Lower than expected production yields could delay product shipments and impair our operating results. We may not obtain acceptable yields in the future.

In some cases, existing manufacturing techniques, which involve substantial manual labor, may not allow us to cost-effectively meet our production goals so that we maintain acceptable gross margins while meeting the cost targets of our customers. We may not achieve adequate manufacturing cost efficiencies.

Because we plan to introduce new products and product enhancements, we must effectively transfer production information from our product development department to our manufacturing group and coordinate our efforts with our suppliers to rapidly achieve volume production. In our experience, our yields have been lower during the early stages of introducing new product to manufacturing. If we fail to effectively manage this process or if we experience delays, disruptions or quality control problems in our manufacturing operations, our shipments of products to our customers could be delayed.

Because the qualification and sales cycle associated with fiber optic components is lengthy and varied, it is difficult to predict the timing of a sale or whether a sale will be made, which may cause us to have excess manufacturing capacity or inventory and negatively impact our operating results.

In the communications industry, service providers and optical systems manufacturers often undertake extensive qualification processes prior to placing orders for large quantities of products such as ours, because these products must function as part of a larger system or network. This process may range from three to six months and sometimes longer. Once they decide to use a particular supplier’s product or component, these potential customers design the product into their system, which is known as a design-in win. Suppliers whose products or components are not designed in are unlikely to make sales to that customer until at least the adoption of a future redesigned system. Even then, many customers may be reluctant to incorporate entirely new products into their new systems, as this could involve significant additional redesign efforts. If we fail to achieve design-in wins in our potential customers’ qualification processes, we will lose the opportunity for significant sales to those customers for a lengthy period of time.

In addition, some of our customers require that our products be subjected to standards-based qualification testing, which can take up to nine months or more. While our customers are evaluating our products and before they place an order with us, we may incur substantial sales and marketing and research and development expenses, expend significant management efforts, increase manufacturing capacity and order long lead-time supplies. Even after the evaluation process, it is possible a potential customer will not purchase our products. In addition, product purchases are frequently subject to unplanned processing and other delays, particularly with respect to larger customers for which our products represent a very small percentage of their overall purchase activity. Accordingly, our revenues and operating results may vary significantly and unexpectedly from quarter to quarter.

If our customers do not qualify our manufacturing lines for volume shipments, our optical networking components may be dropped from supply programs and our revenues may decline.

Customers generally will not purchase any of our products, other than limited numbers of evaluation units, before they qualify our products, approve our manufacturing process and approve our quality assurance system. Our existing manufacturing lines, as well as each new manufacturing line, must pass through various levels of approval with our customers. For example, customers may require that we be registered under international quality standards. Our products may also have to be qualified to specific customer requirements. This customer approval process determines whether the manufacturing line achieves the customers' quality, performance and reliability standards. Delays in product qualification may cause a product to be dropped from a long-term supply program and result in significant lost revenue opportunity over the term of that program.

Our fiber optic components are deployed in large and complex communications networks and may contain defects that are not detected until after our products have been installed, which could damage our reputation and cause us to lose customers.

Our products are designed for deployment in large and complex optical networks. Because of the nature of these products, they can only be fully tested for reliability when deployed in networks for long periods of time. Our fiber optic products may contain undetected defects when first introduced or as new versions are released, and our customers may discover defects in our products only after they have been fully deployed and operated under peak stress conditions. In addition, our products are combined with products from other vendors. As a result, should problems occur, it may be difficult to identify the source of the problem. If we are unable to fix defects or other problems, we could experience, among other things:

- loss of customers;
- damage to our reputation;
- failure to attract new customers or achieve market acceptance;
- diversion of development and engineering resources; and
- legal actions by our customers.

The occurrence of any one or more of the foregoing factors could negatively impact our revenues.

The market for fiber optic components is new and unpredictable, characterized by rapid technological changes, evolving industry standards, and significant changes in customer demand, which could result in decreased demand for our products, erosion of average selling prices, and could negatively impact our revenues.

The market for fiber optic components is new and characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Because this market is new, it is difficult to predict its potential size or future growth rate. Widespread adoption of optical networks, especially in the metropolitan, last mile, and enterprise access segments of the networks, is critical to our future success. Potential end-user customers who have invested substantial resources in their existing copper lines or other systems may be reluctant or slow to adopt a new approach, such as optical networks. Our success in generating revenues in this market will depend on:

- the education of potential end-user customers and network service providers about the benefits of optical networks; and

- the continued growth of the metropolitan, last mile, and enterprise access segments of the communications network.

If we fail to address changing market conditions, sales of our products may decline, which would adversely impact our revenues.

We may be unable to successfully integrate acquired businesses or assets with our business, which may disrupt our business, divert management's attention and slow our ability to expand the range of our proprietary technologies and products.

To expand the range of our proprietary technologies and products, we may acquire complementary businesses, technologies or products, if appropriate opportunities arise. We may be unable to identify other suitable acquisitions at reasonable prices or on reasonable terms, or consummate future acquisitions or other investments, any of which could slow our growth strategy. We may have difficulty integrating the acquired products, personnel or technologies of any company or acquisition that we may make. Similarly, we may not be able to attract or retain key management, technical or sales personnel of any other companies that we acquire or from which we acquire assets. These difficulties could disrupt our ongoing business, distract our management and employees and increase our expenses.

If our common stock is not relisted on the Nasdaq Global Market, we will be subject to certain provisions of the California General Corporation Law that may affect our charter documents and result in additional expenses.

Beginning at the commencement of trading on November 8, 2002, the listing of our common stock was transferred from the Nasdaq Global Market to the Nasdaq Capital Market. As a result, we may become subject to certain sections of the California General Corporation Law that will affect our charter documents if our common stock is not returned to being listed on the Nasdaq Global Market. A recent Delaware decision has called into question the applicability of the California General Corporation Law to Delaware corporations. However, if the California General Corporation Law applies to our Company, we will not be able to continue to have a classified board or continue to eliminate cumulative voting by our stockholders. In addition, certain provisions of our Certificate of Incorporation that call for supermajority voting may need to be approved by stockholders every two years or be eliminated. Also, in the event of a reorganization, stockholders will have dissenting stockholder rights under both California and Delaware law. Any of these changes will result in additional expense as we will have to comply with certain provisions of the California General Corporation Law as well as the Delaware General Corporation Law. We included these provisions in our charter documents in order to delay or discourage a change of control or changes in our management. Because of the California General Corporation Law, we may not be able to avail ourselves of these provisions.

If we are unable to maintain our listing on the Nasdaq Capital Market, the price and liquidity of our common stock may decline.

There can be no assurance that we will be able to satisfy all of the quantitative maintenance criteria for continued listing on the Nasdaq Capital Market, including a requirement that we maintain a continued minimum bid price of $1.00 per share. Beginning on July 20, 2009, if the closing bid price of our common stock falls and remains below $1.00 for 30 consecutive trading days, as it has for significant periods of time in the past, our common stock may not remain listed on the Nasdaq Capital Market. If we fail to maintain continued listing on the Nasdaq Capital Market and must move to a market with less liquidity, our financial condition could be harmed and our stock price would likely decline. If we are delisted, it could have a material adverse effect on the market price of our common stock as well as the liquidity of the trading market for our common stock.

Many companies that face delisting as a result of closing bid prices that are below the Nasdaq Capital Market's continued listing standards seek to maintain the listing of their securities by effecting reverse stock splits. However, reverse stock splits do not always result in a sustained closing bid price per share. We may consider the merits of implementing a reverse split and evaluate other courses of action as we believe may be appropriate.

If we fail to protect our intellectual property rights, competitors may be able to use our technologies, which could weaken our competitive position, reduce our revenues or increase our costs.

The fiber optic component market is a highly competitive industry in which we, and most other participants, rely on a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures and licensing arrangements to establish and protect proprietary rights. The competitive nature of our industry, rapidly changing technology, frequent new product introductions, changes in customer requirements and evolving industry standards heighten the importance of protecting proprietary technology rights. Since the United States Patent and Trademark Office keeps patent applications confidential until a patent is issued, our pending patent applications may attempt to protect proprietary technology claimed in a third party patent application. Our existing and future patents may not be sufficiently broad to protect our proprietary technologies as it is difficult to police the unauthorized use of our products and we cannot be certain that the steps we have taken will prevent the misappropriation or unauthorized use of our technologies, particularly in foreign countries where the laws may not protect our proprietary rights as fully as United States laws. Our competitors and suppliers may independently develop similar technology, duplicate our products, or design around any of our patents or other intellectual property. If we are unable to adequately protect our proprietary technology rights, others may be able to use our proprietary technology without having to compensate us, which could reduce our revenues and negatively impact our ability to compete effectively.

Litigation may be necessary to enforce our intellectual property rights or to determine the validity or scope of the proprietary rights of others. As a result of any such litigation, we could lose our proprietary rights and incur substantial unexpected operating costs. Any action we take to protect our intellectual property rights could be costly and could absorb significant management time and attention. In addition, failure to adequately protect our trademark rights could impair our brand identity and our ability to compete effectively.

We may be subject to intellectual property infringement claims that are costly to defend and could limit our ability to use some technologies in the future.

Our industry is very competitive and is characterized by frequent intellectual property litigation based on allegations of infringement of intellectual property rights. Numerous patents in our industry have already been issued, and as the market further develops and participants in our industry obtain additional intellectual property protection, litigation is likely to become more frequent. From time to time, third parties may assert patent, copyright, trademark and other intellectual property rights to technologies or rights that are important to our business. In addition, we have and we may continue to enter into agreements to indemnify our customers for any expenses or liabilities resulting from claimed infringements of patents, trademarks or copyrights of third parties. Any litigation arising from claims asserting that our products infringe or may infringe the proprietary rights of third parties, whether the litigation is with or without merit, could be time-consuming, resulting in significant expenses and diverting the efforts of our technical and management personnel. We do not have insurance against our alleged or actual infringement of intellectual property of others. These claims could cause us to stop selling our products, which incorporate the challenged intellectual property, and could also result in product shipment delays or require us to redesign or modify our products or to enter into licensing agreements. These licensing agreements, if required, would increase our product costs and may not be available on terms acceptable to us, if at all.

Although we are not aware of any intellectual property lawsuits filed against us, we may be a party to litigation regarding intellectual property in the future. We may not prevail in any such actions, given their complex technical issues and inherent uncertainties. Insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. If there is a successful claim of infringement or we fail to develop non-infringing technology or license the proprietary rights on a timely basis, our business could be harmed.

Because our manufacturing operations are located in active earthquake fault zones in Taiwan, and our Taiwan location is susceptible to the effects of a typhoon, we face the risk that a natural disaster could limit our ability to supply products.

Our primary manufacturing operation is located in Tu-Cheng City, Taiwan, an active earthquake fault zone. This region has experienced large earthquakes in the past and may likely experience them in the future. In September 2001, a typhoon hit Taiwan causing businesses, including our manufacturing facility, and the financial markets to close for two days. A large earthquake or typhoon in Taiwan could disrupt our manufacturing operation in Taiwan for an extended period of time, which would limit our ability to supply our products to our customers in sufficient quantities on a timely basis, harming our customer relationships.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On May 15, 2009, we held our 2009 Annual Meeting of Stockholders, at which meeting our stockholders approved the following:

(a) Election of Class II directors:

	For	Withheld
Gwong-Yih Lee	30,839,723 shares	2,950,328 shares
James C. Yeh	32,431,811 shares	1,358,240 shares

(b) Ratification of the appointment of Stonefield Josephson, Inc. as independent registered public accountants of the Company for the 2009 fiscal year:

For	Against	Abstain
32,263,885 shares	137,874 shares	1,388,288 shares

Other directors whose term of office as a director continued after the Annual Meeting were Peter Chang, Richard Black, and Ray Sun.

ITEM 6: EXHIBITS

Exhibits

Exhibit Number	Title
31.1	Rule 13a-14(a) certification of Chief Executive Officer
31.2	Rule 13a-14(a) certification of Acting Chief Financial Officer
32.1*	Statement of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350).
32.2*	Statement of Acting Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350).

* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

SIGNATURE

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.

Dated: August 12, 2009

ALLIANCE FIBER OPTIC PRODUCTS, INC.

By /s/ Anita K. Ho
Anita K. Ho
Acting Chief Financial Officer
(Principal Financial and Accounting Officer and Duly Authorized Signatory)

Exhibit 31.1

Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for the Period Ended June 30, 200 9

CERTIFICATION

I, Peter C. Chang, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alliance Fiber Optic Products, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date August 12, 2009

By /s/Peter C. Chang
Peter C. Chang
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for the Period Ended June 30, 200 9

CERTIFICATION

I, Anita K. Ho, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alliance Fiber Optic Products, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date August 12, 2009

By /s/Anita K. Ho
Anita K. Ho
Acting Chief Financial Officer
(Principal Accounting Officer)

Exhibit 32.1

STATEMENT OF CHIEF EXECUTIVE OFFICER UNDER 18 U.S.C. § 1350

I, Peter C. Chang, the chief executive officer of Alliance Fiber Optic Products, Inc. (the "Company"), certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code that, to the best of my knowledge,

(i) the Quarterly Report of the Company on Form 10-Q for the period ended June 30, 2009 (the "Report"), fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934, and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Peter C. Chang
Peter C. Chang

August 12, 2009

Exhibit 32.2

STATEMENT OF ACTING CHIEF FINANCIAL OFFICER UNDER 18 U.S.C. § 1350

I, Anita K. Ho, the acting chief financial officer of Alliance Fiber Optic Products, Inc. (the “Company”), certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code that, to the best of my knowledge,

(i) the Quarterly Report of the Company on Form 10-Q for the period ended June 30, 2009 (the “Report”), fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934, and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/Anita K. Ho
Anita K. Ho

August 12, 2009