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AEHR TEST SYSTEMS
Form 10-Q
October 14, 2010

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

For the quarterly period ended August 31, 2010.

OR

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

For the transition period from _____ to _____.

Commission file number: 000-22893.

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

CALIFORNIA

94-2424084

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

400 KATO TERRACE
FREMONT, CA

94539

(Address of principal
executive offices)

(Zip Code)

(510) 623-9400

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE
LAST REPORT.

N/A

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

Yes X No
 --- ---

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

Yes No
 --- ---

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

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

(Do not check if a smaller reporting company)

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

Yes	---	No	X
-----	-----	----	---

Number of shares of common stock, \$0.01 par value, outstanding at September 30, 2010 was 8,678,736.

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FORM 10-Q

FOR THE QUARTER ENDED AUGUST 31, 2010

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PART I. FINANCIAL INFORMATION

Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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

August 31, 2010	May 31, 2010
-----	-----
	(1)

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ASSETS

Current assets:

Cash and cash equivalents	\$ 5,405	\$ 7,766
Accounts receivable, net of allowances for doubtful accounts of \$20 and \$1,411 at August 31, 2010 and May 31, 2010, respectively	1,387	596
Inventories	3,942	3,635
Prepaid expenses and other.	190	445
	-----	-----
Total current assets	10,924	12,442
Property and equipment, net	1,360	1,504
Other assets.	538	528
	-----	-----
Total assets	\$12,822	\$14,474
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Accounts payable.	\$ 772	\$ 703
Accrued expenses.	1,368	1,626
Deferred revenue.	67	286
	-----	-----
Total current liabilities	2,207	2,615
Income tax payable.	298	298
Deferred lease commitment	271	280
	-----	-----
Total liabilities	2,776	3,193
	-----	-----

Shareholders' equity:

Common stock, \$0.01 par value:

Issued and outstanding: 8,679 shares and
8,664 shares at August 31, 2010 and

May 31, 2010, respectively.	87	87
Additional paid-in capital.	46,745	46,459
Accumulated other comprehensive income.	2,685	2,690
Accumulated deficit	(39,471)	(37,955)
	-----	-----
Total shareholders' equity	10,046	11,281
	-----	-----
Total liabilities and shareholders' equity.	\$12,822	\$14,474
	=====	=====

- (1) The condensed consolidated balance sheet at May 31, 2010 has been derived from the audited consolidated financial statements at that date.

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

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(in thousands, except per share data)
(unaudited)

	Three Months Ended August 31,	
	2010	2009
Net sales.	\$2,169	\$1,268
Cost of sales.	1,225	1,325
Gross profit (loss).	944	(57)
Operating expenses:		
Selling, general and administrative.	1,518	1,313
Research and development	1,142	942
Gain on bankruptcy claim	(155)	(3,289)
Total operating expenses	2,505	(1,034)
(Loss) income from operations.	(1,561)	977
Interest income.	2	1
Other income (expense), net.	44	(14)
(Loss) income before income tax expense .	(1,515)	964
Income tax expense	1	3
Net (loss) income.	\$ (1,516)	\$ 961
Net (loss) income per share - basic.	\$ (0.17)	\$ 0.11
Net (loss) income per share - diluted.	\$ (0.17)	\$ 0.11
Shares used in per share calculations:		
Basic	8,667	8,496
Diluted.	8,667	8,512

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

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	Three Months Ended August 31,	
	2010	2009
Cash flows from operating activities:		
Net (loss) income.....	\$ (1,516)	\$ 961
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Stock compensation expense.....	274	305
Provision for doubtful accounts.....	11	6
Loss on disposal of assets.....	2	--
Depreciation and amortization.....	147	181
Changes in operating assets and liabilities:		
Accounts receivable.....	(653)	259
Inventories.....	(307)	355
Deferred lease commitment.....	(9)	(5)
Accounts payable.....	(292)	(551)
Income tax payable.....	(20)	(6)
Accrued expenses and deferred revenue.....	(464)	(356)
Prepaid expenses and other.....	260	(2,865)
Net cash used in operating activities.....	(2,567)	(1,716)
Cash flows from investing activities:		
Net cash used in investing activities.....	--	--
Cash flows from financing activities:		
Proceeds from issuance of common stock and exercise of stock options.....	12	--
Net cash provided by financing activities.....	12	--
Effect of exchange rates on cash.....	194	101
Net decrease in cash and cash equivalents.....	(2,361)	(1,615)
Cash and cash equivalents, beginning of period..	7,766	4,360
Cash and cash equivalents, end of period.....	\$5,405	\$2,745
	=====	=====

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

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

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial information has been prepared by Aehr Test Systems, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or SEC, and therefore does not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America.

In the opinion of management, the unaudited condensed consolidated financial statements for the interim periods presented reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the condensed consolidated financial position and results of operations as of and for such periods indicated. These condensed consolidated financial statements and notes thereto should be read in conjunction with the condensed consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2010. Results for the interim periods presented herein are not necessarily indicative of results which may be reported for any other interim period or for the entire fiscal year.

PRINCIPLES OF CONSOLIDATION. The condensed consolidated financial statements include the accounts of Aehr Test Systems and its subsidiaries (collectively, the "Company," "we," "us," and "our"). All significant intercompany balances have been eliminated in consolidation.

ACCOUNTING ESTIMATES. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ materially from those estimates.

2. STOCK-BASED COMPENSATION

Stock-based compensation expense consists of expenses for stock options and employee stock purchase plan, or ESPP, shares. Stock-based compensation cost is measured at each grant date, based on the fair value of the award using the Black-Scholes option valuation model, and is recognized as expense over the employee's requisite service period. This model was developed for use in estimating the value of publicly traded options that have no vesting restrictions and are fully transferable. The Company's employee stock options have characteristics significantly different from those of publicly traded options. All of the Company's stock compensation is accounted for as an equity instrument. See Notes 8 and 9 in the Company's Annual Report on Form 10-K for fiscal 2010 filed on August 27, 2010 for further information regarding the stock option plan and the ESPP.

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The following table summarizes compensation costs related to the Company's stock-based compensation for the three months ended August 31, 2010 and 2009, respectively (in thousands):

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	Three Months Ended August 31,	
	2010	2009

Stock-based compensation in the form of employee stock options and ESPP shares, included in:		
Cost of sales	\$ 32	\$ 51
Selling, general and administrative	143	151
Research and development	99	103
	-----	-----
Total stock-based compensation	274	305
Tax effect on stock-based compensation	--	--
	-----	-----
Total stock-based compensation, net of tax . . .	\$274	\$305
	=====	=====

During the three months ended August 31, 2010 and 2009, the Company recorded stock-based compensation related to stock options of \$223,000 and \$283,000, respectively.

As of August 31, 2010, the total unrecognized stock-based compensation cost related to unvested stock-based awards under the Company's 1996 Stock Option Plan and 2006 Equity Incentive Plan was approximately \$1,385,000, which is net of estimated forfeitures of \$3,000. This cost will be amortized over the remaining service period of the underlying options. The weighted average period is approximately 3.1 years.

During the three months ended August 31, 2010 and 2009, the Company recorded stock-based compensation related to the ESPP of \$51,000 and \$22,000, respectively.

As of August 31, 2010, the total compensation cost related to options to purchase the Company's common stock under the ESPP but not yet recognized was approximately \$72,000. This cost will be amortized on a straight-line basis over a weighted average period of approximately 0.8 years.

Valuation Assumptions

Valuation and Amortization Method. The Company estimates the fair value of stock options granted using the Black-Scholes option valuation model and a single option award approach for options granted after June 1, 2006. The

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multiple option approach has been used for all options granted prior to June 1, 2006. The fair value under the single option approach is amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. The fair value under the multiple option approach is amortized on a weighted basis over the requisite service periods of the awards, which is generally the vesting period.

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

Expected Volatility. Volatility is a measure of the amounts by which a financial variable such as stock price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company uses the historical volatility for the past five years, which matches the expected term of most of the option grants, to estimate expected volatility.

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

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

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

Fair Value. The fair values of the Company's stock options granted to employees for the three months ended August 31, 2010 and 2009 were estimated using the following weighted average assumptions in the Black-Scholes option valuation model.

	Three months ended August 31,	
	2010	2009
Option Plan Shares		
Expected Term (in years).....	5	5
Volatility.....	0.80	0.78
Expected Dividend.....	\$0.00	\$0.00
Risk-free Interest Rates.....	1.78%	2.54%
Estimated Forfeiture Rate.....	0.25%	0.25%
Weighted Average Grant Date Fair Value.....	\$1.25	\$0.53

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There were no ESPP shares granted to employees for the three months ended August 31, 2010 and 2009.

The following table summarizes the stock option transactions during the three months ended August 31, 2010 (in thousands, except per share data):

	Outstanding Options			
	Available Shares	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balances, May 31, 2010.....	998	1,949	\$3.88	\$883
Options granted.....	(434)	434	\$1.97	
Options terminated.....	115	(115)	\$3.41	
Options exercised.....		(14)	\$0.86	
Plan shares expired.....	(63)			
Balances, August 31, 2010...	616	2,254	\$3.56	\$173
Options exercisable and expected to be exercisable at August 31, 2010		2,208	\$3.56	\$170

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The options outstanding and exercisable at August 31, 2010 were in the following exercise price ranges (in thousands, except per share data):

Options Outstanding at August 31, 2010				Options Exercisable at August 31, 2010			
Range of Exercise Prices	Number Outstanding Shares	Weighted Average Remaining Contractual Life(Years)	Weighted Average Exercise Price	Number Exer- cisable Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
\$0.85-\$0.85	495	3.83	\$0.85	297	\$0.85	3.83	
\$1.29-\$2.81	844	3.82	\$2.18	301	\$2.44	2.68	
\$2.84-\$5.96	460	1.42	\$4.60	418	\$4.46	1.38	
\$6.00-\$9.30	329	2.16	\$7.30	309	\$7.31	2.16	

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\$9.94-\$9.94	126	2.81	\$9.94	68	\$9.94	2.81	
-----			-----				
\$0.85-\$9.94	2,254	3.04	\$3.56	1,393	\$4.16	2.43	\$104
=====			=====				

The total intrinsic values of options exercised were \$1,000 during the three months ended August 31, 2010. There were no stock options exercised for the three months ended August 31, 2009. The weighted average contractual life of the options exercisable and expected to be exercisable at August 31, 2010 was 3.04 years.

Options to purchase 1,393,000 and 1,014,000 shares were exercisable at August 31, 2010 and 2009, respectively. These exercisable options had weighted average exercise prices of \$4.16 and \$4.80 as of August 31, 2010 and 2009, respectively.

3. EARNINGS PER SHARE

Earnings per share is computed based on the weighted average number of common and common equivalent shares (common stock options and ESPP shares) outstanding, when dilutive, during each period using the treasury stock method.

	Three Months Ended August 31,	
	2010	2009
	-----	-----
	(in thousands, except per share amounts)	
Numerator: Net (loss) income	\$ (1,516)	\$ 961
	-----	-----
Denominator for basic net (loss) income per share:		
Weighted-average shares outstanding	8,667	8,496
	-----	-----
Shares used in basic net (loss) income per share calculation.....	8,667	8,496
Effect of dilutive securities.....	--	16
	-----	-----
Denominator for diluted net (loss) income per share.....	8,667	8,512
	-----	-----
Basic net (loss) income per share.....	\$ (0.17)	\$ 0.11
	=====	=====
Diluted net (loss) income per share.....	\$ (0.17)	\$ 0.11
	=====	=====

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potential common shares do not include stock options with an exercise price greater than the average fair value of the Company's common stock for the period, as the effect would be anti-dilutive. Potential common shares have not been included in the calculation of diluted net loss per share for the quarter ended August 31, 2010 as the effect would be anti-dilutive. As such, the numerator and the denominator used in computing both basic and diluted net loss per share for the quarter ended August 31, 2010 are the same. Stock options to purchase 2,254,000 shares of common stock were outstanding on August 31, 2010, but were not included in the computation of diluted net loss per share, because the inclusion of such shares would be anti-dilutive. Stock options to purchase 1,589,000 shares of common stock were outstanding on August 31, 2009, but not included in the computation of diluted net income per share, because the inclusion of such shares would be anti-dilutive.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

On June 1, 2008, the Company adopted authoritative guidance for fair value measurements and the fair value option for financial assets and liabilities. This authoritative guidance defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements.

In the first quarter of fiscal 2010, the Company adopted revised accounting guidance for the fair value measurement and disclosure for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

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

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

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

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

The following table summarizes the Company's assets and liabilities measured at fair value on a recurring basis as of August 31, 2010 (in thousands):

	Balance as of August 31, 2010	Level 1	Level 2
	-----	-----	-----
Money market funds.....	\$4,375	\$4,375	\$ --
	-----	-----	-----
Assets.....	\$4,375	\$4,375	\$ --
	=====	=====	=====

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Liabilities.....	\$ --	\$ --	\$ --
	=====	=====	=====

As of August 31, 2010, the Company did not have any assets or liabilities without observable market values that would require a high level of judgment to determine fair value (Level 3 assets).

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The Company invests in debt and equity of private companies as part of its business strategy. These investments are carried at cost and are included in "Other Assets" in the consolidated balance sheets. If the Company determines that an other-than-temporary decline exists in the fair value of an investment, the Company writes down the investment to its fair value and records the related write-down as an investment loss in "Other Income (Expense)" in its consolidated statements of operations. At August 31, 2010 and May 31, 2010, the carrying value of the strategic investments was \$384,000.

5. INVENTORIES

Inventories are comprised of the following (in thousands):

	August 31, 2010	May 31, 2010
	-----	-----
Raw materials and sub-assemblies.....	\$1,293	\$ 754
Work in process.....	2,518	2,633
Finished goods.....	131	248
	-----	-----
	\$3,942	\$3,635
	=====	=====

6. SEGMENT INFORMATION

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

The following presents information about the Company's operations in different geographic areas (in thousands):

	United States	Asia	Europe	Total
	-----	-----	-----	-----
Three months ended August 31, 2010:				
Net sales.....	\$1,609	\$499	\$61	\$2,169
Property and equipment, net.....	1,268	79	13	1,360

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Three months ended August 31, 2009:

Net sales.....	\$1,068	\$77	\$123	\$1,268
Property and equipment, net.....	2,466	86	11	2,563

The Company's foreign operations are primarily those of its Japanese and German subsidiaries. Substantially all of the sales of the subsidiaries are made to unaffiliated Japanese or European customers. Net sales from outside the United States include those of Aehr Test Systems Japan K.K. and Aehr Test Systems GmbH.

Sales to the Company's five largest customers accounted for approximately 93% and 81% of its net sales in the three months ended August 31, 2010 and 2009, respectively. Four customers accounted for approximately 39%, 22%, 17% and 13% of the Company's net sales in the three months ended August 31, 2010. Four customers accounted for approximately 29%, 18%, 15% and 13% of the Company's net sales in the three months ended August 31, 2009. No other customers represented more than 10% of the Company's net sales for either of the three months ended August 31, 2010 and 2009.

7. PRODUCT WARRANTIES

The Company provides for the estimated cost of product warranties at the time products are shipped. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, the Company's warranty obligation is affected by product failure rates, material usage and service delivery costs

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incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from the Company's estimates, revisions to the estimated warranty liability would be required.

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

Following is a summary of changes in the Company's liability for product warranties during the three months ended August 31, 2010 and 2009 (in thousands):

	Three Months Ended August 31,	
	2010	2009
Balance at the beginning of the period.....	\$174	\$314
Accruals for warranties issued during the period.....	21	28
Adjustments related to pre-existing warranties (including changes in estimates).....	(88)	--
Settlement made during the period		

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(in cash or in kind)	(13)	(57)
	-----	-----
Balance at the end of the period.....	\$94	\$285
	=====	=====

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

8. OTHER COMPREHENSIVE (LOSS) INCOME

Other comprehensive (loss) income, net of tax is comprised of the following (in thousands):

	Three Months Ended August 31,	
	-----	-----
	2010	2009
	-----	-----
Net (loss) income.....	\$(1,516)	\$961
Foreign currency translation adjustments	(5)	18
	-----	-----
Comprehensive (loss) income.....	\$(1,521)	\$979
	=====	=====

9. INCOME TAXES

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

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

The Company accounts for uncertain tax positions consistent with authoritative guidance. The guidance prescribes a "more likely than not" recognition threshold and measurement attribute for the financial statement

recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company does not expect any material change in its unrecognized tax benefits over the next twelve months. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income taxes.

Although the Company files U.S. federal, various state, and foreign tax

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returns, the Company's only major tax jurisdictions are the United States, California, Germany and Japan. Tax years 1996 - 2009 remain subject to examination by the appropriate governmental agencies due to tax loss carryovers from those years.

10. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, the Financial Accounting Standards Board, or FASB, issued authoritative guidance for revenue recognition with multiple deliverables. This authoritative guidance defines the criteria for identifying individual deliverables in a multiple-element arrangement and the manner in which revenues are allocated to individual deliverables. In absence of vendor-specific objective evidence, or VSOE, or other third party evidence, or TPE, of the selling price for the deliverables in a multiple-element arrangement, guidance requires companies to use an estimated selling price, or ESP, for the individual deliverables. Companies shall apply the relative-selling price model for allocating an arrangement's total consideration to its individual elements. Under this model, the ESP is used for both the delivered and undelivered elements that do not have VSOE or TPE of the selling price. This guidance is effective for fiscal years beginning on or after June 15, 2010, and will be applied prospectively to revenue arrangements entered into or materially modified after the effective date. The Company will adopt this guidance in the first quarter of fiscal year 2012.

In October 2009, the FASB issued authoritative guidance for the accounting for certain revenue arrangements that include software elements. This authoritative guidance amends the scope of pre-existing software revenue guidance by removing from the guidance non-software components of tangible products and certain software components of tangible products. This guidance is effective for fiscal years beginning on or after June 15, 2010, and will be applied prospectively to revenue arrangements entered into or materially modified after the effective date. The Company will adopt this guidance in the first quarter of fiscal year 2012.

In January 2010, the FASB issued amended standards that require additional fair value disclosures. These amended standards require disclosures for significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers and activity. For Level 3 fair value measurements, purchases, sales, issuances and settlements must be reported on a gross basis. Further, additional disclosures are required by class of assets or liabilities, as well as inputs used to measure fair value and valuation techniques. The Company adopted these standards in the first quarter of 2010. These standards did not have a material impact on the Company's condensed consolidated financial statements.

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

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes that appear elsewhere in this report and with our Annual Report on Form 10-K for the fiscal year ended May 31, 2010 and the condensed consolidated financial statements and notes thereto.

In addition to historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as

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

OVERVIEW

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

The Company's net sales consist primarily of sales of systems, test fixtures, die carriers, upgrades and spare parts and revenues from service contracts and cancellation charges. The Company's selling arrangements may include contractual customer acceptance provisions and installation of the product occurs after shipment and transfer of title.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to customer programs and incentives, product returns, bad debts, inventories, investments, intangible assets, income taxes, financing operations, warranty obligations, long-term service contracts, and contingencies and litigation. The Company bases its 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 of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. For a discussion of the critical accounting policies, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies

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and Estimates" in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2010. We believe there have been no material changes to our critical accounting policies and estimates during the three months ended August 31, 2010 compared to those discussed in our Annual Report on Form 10-K for the fiscal year ended May 31, 2010.

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RESULTS OF OPERATIONS

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

	Three Months Ended August 31,	
	2010	2009
Net sales.	100.0 %	100.0 %
Cost of sales.	56.5	104.5
Gross profit (loss).	43.5	(4.5)
Operating expenses:		
Selling, general and administrative.	70.0	103.5
Research and development	52.7	74.3
Gain on sale of bankruptcy claim	(7.2)	(259.3)
Total operating expenses	115.5	(81.5)
(Loss) income from operations.	(72.0)	77.0
Interest income.	0.1	0.1
Other income (expense), net.	2.0	(1.1)
(Loss) income before income tax Expense.	(69.9)	76.0
Income tax expense	--	0.2
Net (loss) income.	(69.9)%	75.8 %

THREE MONTHS ENDED AUGUST 31, 2010 COMPARED TO THREE MONTHS ENDED AUGUST 31, 2009

NET SALES. Net sales increased to \$2.2 million for the three months ended August 31, 2010 from \$1.3 million for the three months ended August 31, 2009, an increase of 71.1%. The increase in net sales for the three months ended August 31, 2010 resulted primarily from an increase in net sales of the Company's wafer-level products. Net sales of the Company's wafer-level products for the three months ended August 31, 2010 were \$1.1 million, and increased approximately \$1.0 million from the three months ended August 31, 2009.

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GROSS PROFIT (LOSS). Gross profit (loss) consists of net sales less cost of sales. Cost of sales consists primarily of the cost of materials, assembly and test costs, and overhead from operations. Gross profit increased to \$944,000 for the three months ended August 31, 2010 from gross loss of \$57,000 for the three months ended August 31, 2009, an increase of \$1.0 million. Gross profit margin increased to 43.5% for the three months ended August 31, 2010 from -4.5% for the three months ended August 31, 2009. The increase in gross profit margin was primarily the result of manufacturing efficiencies resulting from increased production levels, and, to a similar extent, the high margins on sales of certain goods which had previously been partially or wholly reserved.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative, or SG&A, expenses consist primarily of salaries and related costs of employees, commission expenses to independent sales representatives, product promotion and other professional services. SG&A expenses of \$1.5 million for the three months ended August 31, 2010 increased from \$1.3 million for the

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three months ended August 31, 2009, an increase of 15.6%. The increase in SG&A expense was primarily due to an increase in employment related expenses.

RESEARCH AND DEVELOPMENT. Research and development, or R&D, expenses consist primarily of salaries and related costs of employees engaged in ongoing research, design and development activities, costs of engineering materials and supplies, and professional consulting expenses. R&D expenses of \$1.1 million for the three months ended August 31, 2010 increased from \$0.9 million for the three months ended August 31, 2009, an increase of 21.2%. This increase was primarily attributable to an increase in employment related expenses.

GAIN ON BANKRUPTCY CLAIM. Spansion, the Company's largest customer in fiscal 2009 and 2010, filed for bankruptcy in Japan in February 2009 and in the United States in March 2009. The Company filed claims in the Spansion U.S. and Spansion Japan bankruptcy actions. In the first quarter of fiscal 2010, the Company sold a portion, \$11.4 million, of its Spansion U.S. bankruptcy claim to a third party for net proceeds of \$3.3 million and recorded the amount as a reduction of operating expenses. In the first quarter of fiscal 2011, the Company's Japanese subsidiary received \$155,000 in proceeds from the Spansion Japan bankruptcy claim and recorded the amount as a reduction of operating expenses.

INTEREST INCOME. Interest income increased to \$2,000 for the three months ended August 31, 2010 from \$1,000 for the three months ended August 31, 2009. The increase in interest income for the three months ended August 31, 2010 was primarily related to a higher average cash and cash equivalent balance.

OTHER INCOME (EXPENSE), NET. Other income was \$44,000 for the three months ended August 31, 2010, compared with \$14,000 of other expense for the three months ended August 31, 2009. The increase in other income (expense), net was primarily attributable to foreign exchange gains recognized in the first fiscal quarter of 2011 compared to foreign exchange losses recognized in the first fiscal quarter of 2010.

INCOME TAX EXPENSE. Income tax expense was \$1,000 for the three months ended August 31, 2010, compared with \$3,000 for the three months ended August 31, 2009. A low effective tax rate was recognized for the three months ended August 31, 2010 and 2009 as no benefit is being recorded due to a full valuation allowance. During the third quarter of fiscal 2009, the Company

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established a valuation allowance for the full amount of its net deferred tax assets for both its U.S. operations and its Japanese subsidiary as it was determined that it is more likely than not that such assets will not be realized.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities was \$2.6 million for the three months ended August 31, 2010 and \$1.7 million for the three months ended August 31, 2009. For the three months ended August 31, 2010, net cash used in operating activities was primarily driven by net loss of \$1.5 million, partially offset by an increase of \$0.7 million in accounts receivable. The increase in accounts receivable was primarily due to increases in customer balances. For the three months ended August 31, 2009, net cash used in operating activities was primarily driven by an increase of \$2.9 million in prepaid expenses and other, partially offset by net income of \$961,000. The increase in prepaid expenses and other was primarily due to the sale of a part of the Company's Spansion U.S. bankruptcy claim for \$3.3 million.

Net cash provided by investing activities were \$0 for the three months ended August 31, 2010 and 2009.

Financing activities provided cash of \$12,000 for the three months ended August 31, 2010 and \$0 for the three months ended August 31, 2009.

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As of August 31, 2010, the Company had working capital of \$8.7 million. Working capital consists of cash and cash equivalents, accounts receivable, inventory and other current assets, less current liabilities.

The Company announced in August 1998 that its board of directors had authorized the repurchase of up to 1,000,000 shares of its outstanding common stock. From time to time, the Company may repurchase the shares in the open market or in privately negotiated transactions, subject to market conditions. The number of shares of common stock actually acquired by the Company will depend on subsequent developments and corporate needs, and the repurchase program may be interrupted or discontinued at any time. If consummated, any such repurchase of shares may use a portion of the Company's working capital. As of May 31, 2006, the Company had repurchased 523,700 shares at an average price of \$3.95. Shares repurchased by the Company are cancelled. During fiscal 2010, 2009 and 2008, the Company did not repurchase any of its outstanding common stock.

The Company leases its manufacturing and office space under operating leases. The Company entered into a non-cancelable operating lease agreement for its United States manufacturing and office facilities, which commenced in April 2008 and expires in June 2015. Under the lease agreement, the Company is responsible for payments of utilities, taxes and insurance.

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

The Company anticipates that the existing cash balance together with cash flows from operations, will be adequate to meet its working capital and capital

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equipment requirements through fiscal 2011. After fiscal 2011, depending on its rate of growth and profitability, the Company may require additional equity or debt financing to meet its working capital requirements or capital equipment needs. There can be no assurance that additional financing will be available when required, or if available, that such financing can be obtained on terms satisfactory to the Company.

OFF-BALANCE SHEET ARRANGEMENTS

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

OVERVIEW OF CONTRACTUAL OBLIGATIONS

There have been no material changes in the composition, magnitude or other key characteristics of the Company's contractual obligations or other commitments as disclosed in the Company's Annual Report on Form 10-K for the year ended May 31, 2010.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company is exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. Through April 2008, the Company invested excess cash in a managed portfolio of corporate and government bond instruments with maturities of 18 months or less. Beginning in May 2008, the Company adopted a revised cash investment policy which only invests in government-backed securities with maturities of 18 months or less. The Company does not use any financial instruments for speculative or trading purposes. Fluctuations in interest rates would not have a material effect on the Company's financial position, results of operations or cash flows.

A majority of the Company's revenue and capital spending is transacted in U.S. Dollars. The Company, however, enters into transactions in other currencies, primarily Japanese Yen. Substantially all sales to Japanese

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customers are denominated in Yen. Since the price is determined at the time a purchase order is accepted, the Company is exposed to the risks of fluctuations in the Yen-U.S. Dollar exchange rate during the lengthy period from purchase order to ultimate payment. This exchange rate risk is partially offset to the extent that the Company's Japanese subsidiary incurs expenses payable in Yen. To date, the Company has not invested in instruments designed to hedge currency risks. In addition, the Company's Japanese subsidiary typically carries debt or other obligations due to the Company that may be denominated in either Yen or U.S. Dollars. Since the Japanese subsidiary's financial statements are based in Yen and the Company's condensed consolidated financial statements are based in U.S. Dollars, the Japanese subsidiary and the Company recognize foreign exchange gain or loss in any period in which the value of the Yen rises or falls in relation to the U.S. Dollar. A 10% decrease in the value of the Yen as compared with the U.S. Dollar would not be expected to result in a significant change to the Company's net income or loss.

The Company had no holdings of derivative financial or commodity instruments at August 31, 2010.

Item 4. CONTROLS AND PROCEDURES

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

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

Item 1A. RISK FACTORS

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

Current global economic conditions could materially adversely affect the Company's operations and performance.

Our operations and performance depend significantly on worldwide economic conditions. The current financial turmoil affecting the banking system and financial markets has resulted in a tightening of the credit markets, disruption in the financial markets and global economy downturn. These events contributed to significant slowdowns in the industries in which we operate. Difficulties in obtaining capital and deteriorating market conditions pose the risk that some of our customers may not be able to obtain necessary financing on reasonable terms, which could result in lower sales for the Company. Customers with liquidity issues may lead to additional bad debt expense for the Company. For example, Spansion declared bankruptcy in Japan and the U.S. during fiscal 2009; as a result the Company subsequently recorded a \$13.7 million provision for bad debts. These conditions may also similarly affect our key suppliers, which could impact their ability to deliver parts and result in delays in deliveries of our products.

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

If we are not able to reduce our operating expenses during periods of weak revenue, or if we utilize significant amounts of cash to support operating losses and do not have the ability to raise additional debt or equity financing, we may erode our cash resources and may not have sufficient cash to operate our business.

In the face of the current sustained downturn in our business and decline in our net sales, we have implemented a variety of cost controls and restructured our operations with the goal of reducing our operating costs to position ourselves to more effectively meet the needs of the currently weak market for test and burn-in equipment. While we took significant steps in fiscal 2009 to minimize our expense levels and to increase the likelihood that we would have sufficient cash to support operations during the downturn, during fiscal 2009 and fiscal 2010 we experienced operating losses. Due primarily to these operating losses in fiscal 2009 and fiscal 2010, we experienced net cash outflows. Should our business downturn be prolonged, and if we are unable to reduce our operating expenses sufficiently, we may require additional debt or equity financing to meet working capital or capital expenditure needs. While we believe our cash balances together with cash

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flows from operations will be sufficient to satisfy our cash requirements through fiscal 2011, we cannot determine with certainty that, if needed, we will be able to raise additional funding through either equity or debt financing under these circumstances or on what terms such financing would be available.

We depend on a small number of key customers in the semiconductor manufacturing industry for a large portion of our revenues.

The semiconductor manufacturing industry is highly concentrated, with a relatively small number of large semiconductor manufacturers and contract assemblers accounting for a substantial portion of the purchases of semiconductor equipment. Sales to the Company's five largest customers accounted for approximately 85% and 95% of its net sales in fiscal 2010 and 2009, respectively. During fiscal 2010, Spansion, Micronas Semiconductor Holding AG and Texas Instruments Incorporated accounted for approximately 55%, 12% and 11%, respectively, of the Company's net sales. During fiscal 2009, one customer, Spansion, accounted for approximately 80% of the Company's net sales. No other customers represented more than 10% of the Company's net sales for either fiscal 2010 or fiscal 2009.

We expect that sales of our products to a limited number of customers will continue to account for a high percentage of net sales for the foreseeable future. In addition, sales to particular customers may fluctuate significantly from quarter to quarter. The loss of, or reduction or delay in an order, or orders from a significant customer, or a delay in collecting or failure to collect accounts receivable from a significant customer could adversely affect our business, financial condition and operating results. For example, during fiscal 2009 Spansion declared bankruptcy in Japan and in the U.S., and

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subsequently placed lower levels of orders with the Company, which caused our net sales to drop dramatically and impacted the ability to collect on accounts receivables.

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

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

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

A principal element of our business strategy is to capture an increasing share of the test equipment market through sales of our FOX wafer-level test and burn-in system. The FOX system is designed to simultaneously burn-in and functionally test all of the die on a wafer. The market for the FOX systems

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

We rely on market acceptance for our ABTS system and we may not be able to achieve sufficient market acceptance to allow our ABTS system to be commercially viable.

Since the introduction of the ABTS product in fiscal 2008, the Company has

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shipped a limited number of ABTS systems. Market acceptance of the ABTS system is subject to a number of risks. We must complete engineering development of certain necessary hardware and software features. In addition, it is important that we achieve customer satisfaction and acceptance of the ABTS products. Additional customers must then be found who are willing to place orders for ABTS systems in sufficient quantities to allow it to be produced economically.

We depend upon continued market acceptance for our MAX system and we may experience a limited burn-in system market.

We have historically derived a substantial portion of our net sales from the sale of dynamic burn-in systems. We believe that the market for burn-in systems is mature and is not expected to experience significant long-term growth in the future. In general, process control improvements in the semiconductor industry have tended to reduce burn-in times. In addition, as a given IC product generation matures and yields increase, the required burn-in time may be reduced or eliminated. IC manufacturers, which historically have been our primary customer base, increasingly outsource test and burn-in to independent test labs, which often build their own systems. Our success depends upon the continued acceptance of our MAX burn-in products within these markets. There can be no assurance that the market for burn-in systems will grow, or that sales of our MAX burn-in products may not decline.

Our business may suffer due to risks associated with international sales and operations.

Approximately 29%, 72% and 61% of our net sales for fiscal 2010, 2009 and 2008, respectively, were attributable to sales to customers for delivery outside of the United States. We operate sales, service and limited manufacturing organizations in Japan and Germany and a sales and support organization in Taiwan. We expect that sales of products for delivery outside of the United States will continue to represent a substantial portion of our future net sales. Our future performance will depend, in significant part, upon our ability to continue to compete in foreign markets which in turn will depend, in part, upon a continuation of current trade relations between the United States and foreign countries in which semiconductor manufacturers or assemblers have operations. A change toward more protectionist trade legislation in either the United States or such foreign countries, such as a change in the current tariff structures, export compliance or other trade policies, could adversely affect our ability to sell our products in foreign markets. In addition, we are subject to other risks associated with doing business internationally, including longer receivable collection periods and greater difficulty in accounts receivable collection, the burden of complying with a variety of foreign laws, difficulty in staffing and managing global operations, risks of civil disturbance or other events which may limit or

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disrupt markets, international exchange restrictions, changing political conditions and monetary policies of foreign governments.

Turmoil in the international financial markets has resulted, and may result in the future, in dramatic currency devaluations, stock market declines, restriction of available credit and general financial weakness. In addition, flash, DRAM and other memory device prices have historically declined, and may do so again in the future. These developments may affect us in several ways. We believe that many international semiconductor manufacturers limited their capital spending in fiscal 2009, and that the uncertainty of the memory market

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may cause some manufacturers in the future to again delay capital spending plans. Economic conditions may also affect the ability of our customers to meet their payment obligations, resulting in cancellations or deferrals of existing orders and limiting additional orders. In addition, some governments have subsidized portions of fabrication facility construction. Financial turmoil may reduce these governments' willingness to continue such subsidies. Such developments could have a material adverse affect on our business, financial condition and results of operations.

Approximately 95%, 2% and 3% of our net sales for fiscal 2010 were denominated in U.S. Dollars, Japanese Yen and Euros, respectively. Although a large percentage of net sales to European customers are denominated in U.S. Dollars, substantially all sales to Japanese customers are denominated in Yen. Because a substantial portion of our net sales is from sales of products for delivery outside the United States, an increase in the value of the U.S. Dollar relative to foreign currencies would increase the cost of our products compared to products sold by local companies in such markets. In addition, since the price is determined at the time a purchase order is accepted, we are exposed to the risks of fluctuations in the U.S. Dollar exchange rate during the lengthy period from the date a purchase order is received until payment is made. This exchange rate risk is partially offset to the extent our foreign operations incur expenses in the local currency. To date, we have not invested in instruments designed to hedge currency risks. Our operating results could be adversely affected by fluctuations in the value of the U.S. Dollar relative to other currencies.

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

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

Because of the complexity of our products, significant delays can occur between a product's introduction and the commencement of the volume production of such product. We have experienced, from time to time, significant delays in the introduction of, and technical and manufacturing difficulties with, certain of our products and may experience delays and technical and manufacturing difficulties in future introductions or volume production of our new products. Our inability to complete new product development, or to

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manufacture and ship products in time to meet customer requirements would materially adversely affect our business, financial condition and results of operations.

We may experience product delays and increased costs associated with new product introductions.

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

We depend on subcontractors and sole or limited sources of supply.

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

Future changes in semiconductor technologies may make our products obsolete.

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

Semiconductor business cycles are unreliable and there is always the risk of cancellations and rescheduling which could have a material adverse affect on our operating results.

Our operating results depend primarily upon the capital expenditures of semiconductor manufacturers, semiconductor contract assemblers and burn-in and test service companies worldwide, which in turn depend on the current and anticipated market demand for ICs. The semiconductor and semiconductor

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equipment industries in general, and the market for flash memories, DRAMs and other memory devices, in particular, have historically been highly volatile and have experienced periodic downturns and slowdowns, which have had severe, negative effects on the semiconductor industry's demand for semiconductor capital equipment, including test and burn-in systems manufactured and

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marketed by the Company. These downturns and slowdowns have adversely affected our operating results in the past. There can be no assurance that the semiconductor industry will grow in the future at the same rates as it has grown historically. Any downturn or slowdown in the semiconductor industry would have a material adverse effect on our business, financial condition and operating results. In addition, the need to maintain investment in research and development and to maintain customer service and support will limit our ability to reduce our expenses in response to any such downturn or slowdown period.

The semiconductor equipment manufacturing industry has historically been subject to a relatively high rate of purchase order cancellation by customers as compared to other high technology industry sectors. Manufacturing companies that are the customers of semiconductor equipment companies frequently revise, postpone and cancel capital facility expansion plans. In such cases, semiconductor equipment companies may experience a significant rate of cancellations or rescheduling of purchase orders. A significant increase in purchase order cancellations was recognized in the third quarter of fiscal 2009 as a result of the Spansion bankruptcy filing. There can be no assurance that we will not be materially adversely affected by future cancellations or rescheduling of purchase orders.

Our stock price may fluctuate.

The price of our common stock has fluctuated in the past and may fluctuate significantly in the future. We believe that factors such as announcements of developments related to our business, fluctuations in our operating results, failure to meet securities analysts' expectations, general conditions in the semiconductor and semiconductor equipment industries and the worldwide economy, announcement of technological innovations, new systems or product enhancements by us or our competitors, fluctuations in the level of cooperative development funding, acquisitions, changes in governmental regulations, developments in patents or other intellectual property rights and changes in our relationships with customers and suppliers could cause the price of our common stock to fluctuate substantially. In addition, in recent years the stock market in general, and the market for small capitalization and high technology stocks in particular, have experienced extreme price fluctuations which have often been unrelated to the operating performance of the affected companies. Such fluctuations could adversely affect the market price of our common stock.

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

Our success depends to a significant extent upon the continued service of Rhea Posedel, our Chief Executive Officer, as well as other executive officers and key employees. We do not maintain key person life insurance for our benefit on any of our personnel, and none of our employees are subject to a non-competition agreement with the Company. The loss of the services of any of

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our executive officers or a group of key employees could have a material adverse effect on our business, financial condition and operating results. Our future success will depend in significant part upon our ability to attract and retain highly skilled technical, management, sales and marketing personnel. There is a limited number of personnel with the requisite skills to serve in these positions, and it has become increasingly difficult for us to hire such personnel. Competition for such personnel in the semiconductor equipment industry is intense, and there can be no assurance that we will be successful in attracting or retaining such personnel. Changes in management could disrupt our operations and adversely affect our operating results.

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

If we do not adequately protect our intellectual property, competitors may be able to use our proprietary information to erode our competitive advantage, and our business and operating results could be harmed. Litigation may be

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necessary to enforce or determine the validity and scope of our proprietary rights, and there can be no assurance that our intellectual property rights, if challenged, will be upheld as valid. Such litigation could result in substantial costs and diversion of resources and could have a material adverse effect on our operating results, regardless of the outcome of the litigation. In addition, there can be no assurance that any of the patents issued to us will not be challenged, invalidated or circumvented or that the rights granted thereunder will provide competitive advantages to us.

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

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

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

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regulations. Any failure by us to control the use, disposal or storage of or adequately restrict the discharge of, hazardous or toxic substances could subject us to significant liabilities.

While we believe we currently have adequate internal control over financial reporting, we are required to assess our internal control over financial reporting on an annual basis and any future adverse results from such assessment could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we must include in our Annual Report on Form 10-K a report of management on the effectiveness of our internal control over financial reporting. If we fail to maintain effective internal control over financial reporting, or management does not timely assess the adequacy of such internal control, we could be subject to regulatory sanctions and the public's perception may decline.

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

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

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Item 4. (REMOVED AND RESERVED)

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

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

SIGNATURES

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

Aehr Test Systems
(Registrant)

Date: October 14, 2010

/s/ RHEA J. POSEDEL

Rhea J. Posedel
Chief Executive Officer and
Chairman of the Board of Directors

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Date: October 14, 2010

/s/ GARY L. LARSON

Gary L. Larson
Vice President of Finance and
Chief Financial Officer

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AEHR TEST SYSTEMS INDEX TO EXHIBITS

Exhibit No.	Description
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3.1(1)	Restated Articles of Incorporation of the Company.
3.2(2)	Amended and Restated Bylaws of the Company.
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32 (3)	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference to the same-numbered exhibit previously filed with the Company's Registration Statement on Form S-1 filed June 11, 1997 (File No. 333-28987).

(2) Incorporated by reference to the same-numbered exhibit previously filed with the Company's Quarterly Report on Form 10-Q filed April 13, 2009 (File No. 000-22893).

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

