NASDAQ:AAOI Q4 2025 Earnings Call Transcript

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Conference Operator | Operator:

Good afternoon. I will be your conference operator on today's call. At this time, I would like to welcome everyone to Applied Opto-Electronics' fourth quarter and full year 2025 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer session. To ask a question, you may press star, then one on your telephone keypad. And to withdraw a question, please press star, then two. Please also note that this call is being recorded today. I'll now turn the call over to Lindsay Savarese, Investor Relations for AOI. Ms. Savarese, you may begin.

Lindsay Savarese | Investor Relations, Applied Optoelectronics:

Thank you. I'm Lindsay Savarese, Investor Relations for Applied Optoelectronics. I'm pleased to welcome you to AOI's fourth quarter and full year 2025 Financial Results Conference Call. After the market closed today, AOI issued a press release. announcing its fourth quarter and full year 2025 financial results and provided its outlook for the first quarter of 2026. The release is also available on the company's website at ao-inc.com. This call is being recorded and webcast live. A link to the recording can be found on the investor relations section of the AOI website and will be archived for one year. Joining us on today's call is Dr. Thompson Lin, AOI's founder, chairman, and CEO. and Dr. Stephan Murray, AOI's Chief Financial Officer and Chief Strategy Officer. Thompson will give an overview of AOI's Q4 results, and Stephan will provide financial details and the outlook for the first quarter of 2026. A question and answer session will follow our prepared remarks. Before we begin, I would like to remind you to review AOI's Safe Harbor Statement. On today's call, management will make forward-looking statements. These forward-looking statements involve risks and uncertainties as well as assumptions and current expectations, which could cause the company's actual results, levels of activity, performance or achievements of the company or its industry to differ materially from those expressed or implied in such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as believes, forecasts, anticipates, estimates, suggests, intends, predicts, expects, plans, may, should, could, would, will, potential, or thinks, or by the negative of those terms or other similar expressions, that convey uncertainty of future events or outcomes. The company has based these forward-looking statements on its current expectations, assumptions, estimates and projections. While the company believes these expectations, assumptions, estimates and projections are reasonable, such forward-looking statements are only predictions and involve known and unknown risks and uncertainties, many of which are beyond the company's control. Forward-looking statements also include statements regarding management's beliefs and expectations related to the expansion of the reach of its products into new markets and customer responses to its innovations, as well as statements regarding the company's outlook for the first quarter of 2026 and for the full year of 2026. Except as required by law, AOI assumes no obligation to update these forward-looking statements for any reason after the date of this earnings call. inform these statements to actual results or to changes in the company's expectations. More information about other risks that may impact the company's business are set forth in the risk factors section of AOI's reports on file with the SEC, including the company's annual report on Form 10-K and quarterly reports on Form 10-Q. Also, all financial results and other financial measures discussed today are on a non-GAAP basis unless specifically noted otherwise. Non-GAAP financial measures are not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP. A reconciliation between our GAAP and non-GAAP measures, as well as a discussion of why we present non-GAAP financial measures, are included in the company's earnings press release that is available on AOI's website. Before moving to the financial results, I'd like to note that AOI management is attending the

Susquehanna Annual Technology Conference virtually tomorrow, as well as the Raymond James Annual Institutional Investors Conference on March 3rd. Additionally, management will host an investor session at OSC on Tuesday, March 17th in Los Angeles. This discussion will be webcast live, and a link to the webcast is available on the Investor Relations section of the AOI website. Lastly, I'd like to note that the date of AOI's first quarter 2026 earnings call is currently scheduled for May 7, 2026. Now, I would like to turn the call over to Dr. Thompson Lin, AOI's founder, chairman, and CEO. Thompson?

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

Thank you, Lindsay. Thank you for joining our call today. We are pleased to deliver regular fourth quarter results that were in line with or better than our expectations and which came out the strongest year in our company's history. Our results were driven by robust demand in both our CATV and data center business. In 2025, total revenue increased 83% compared to 2024 to a record $456 million. Data center revenue of $196 million increased 32% compared to 2024. While our CATV revenue nearly tripled to $245 million in the same period, we entered 2026 with strong momentum, and due to the softball investment we have made, we have materially expanded our manufacturing capacity. We bear this position as well to meet increasing customer demand and we are lead to accelerating growth this year. During the quarter, we announced that we'd received our fourth Air Energy Valiant Order from one of our major hyperscale customers to support its AI data center growth. This was an important milestone in our next-generation data center roadmap and followed the successful qualification of our Air Energy products by the customer. It also reflects both the strengths of our product portfolio and the deepened relationship we have with this hyperscale customer. We continue to work with this customer to finalize the firmware used in this module to ensure interoperability across their network, which we believe will be completed in March. We have begun ramping up production of this 800G module in anticipation of a strong volume ramp starting in Q2. Focused demand for 800G modules are projected to exceed our production capacity through mid-2027, and we are working to add additional capacity to meet this demand. During the quarter, we saw particular strengths for our 400G products with this customer, which more than offset our 800G revenue. which came in below our expectation of $4 million to $8 million. Due to the ongoing firmware optimizations I mentioned above, looking ahead, we expect continued strength in our 400G business. Also, 800G is expected to dominate our revenue beginning in Q2. As a reminder, our Taiwan facility was already qualified for production of several 800G product types from this hyperscale customer during 2025. Our Texas facility was also qualified for production of some of our 800G products. During the quarter, we made an investment with qualifying additional products from our Texas facility with this customer and expect full qualification by mid-year. We expect that we move throughout the year to ship an increasing amount of AIG products from our Texas facility as we expand our capacity. In addition to this fourth major AIG customer, we have had indications from another existing hyperscale customer that they intend to begin to order AIG from us soon. Finally, a new Hyperscale customer has begun discussion about qualifying our 800G and 1.6T products just within the last few weeks. So we feel increasingly confident about our trajectory in 800G and 1.6T receiver with multiple customers. During the first quarter, we delivered revenue of $134.3 million which was in line with our guidance range of $125 million to $140 million. We recorded non-GAAP gross margin of 31.4%, which was above the high end of our guidance range of 29% to 31%, and our non-GAAP loss per share of $0.01 was narrower than our garden range of a loss of 13 cents to a loss of 4 cents. Total revenue for our data center product of $74.9 million increased 69% year-over-year and 70% sequentially. Sales of our 1G product increased 54% year-over-years and sales for our 4G product increased 141% year-over-years. Total revenue in Q4 in our CATV segment was $54 million, which was up 3% year-over-years and in line with our expectations was down 24% sequentially from a record Q3s. Similar to the last couple of quarters, we ship a significant quantity of 1.8 GHz amplifiers to our largest DATB customers in Q4, and demand from them continues to be robust. In addition to these customers, we continue to see momentum from a new set of MSO customers. With that, I will turn the call over to Stephen to review the details of our Q4 performance and outlook for Q1. Stephen.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Thank you, Thompson. As Thompson mentioned, we are pleased to deliver record fourth quarter results that were in line with or better than our expectations and which capped off the strongest year in our company's history. Our performance was driven by robust demand in both our CATV and data center businesses. We enter 2026 with strong momentum, and due to the thoughtful investments we have made, we have materially expanded our manufacturing capacity. We believe this positions us well to meet increasing customer demand and will lead to accelerating growth this year. Throughout 2025, our focus remained on a few key priorities. One, scaling our next generation data center products, including both our 400G and 800G solutions. Two, expanding our production capacity in a disciplined manner to support anticipated demand, particularly in our Texas factory. Three, diversifying our revenue base. And four, strengthening operational execution to improve our margins and long-term profitability. I'm pleased to report that we made significant progress on each of these fronts and these will continue to be key priorities in 2026. Importantly, we saw and continue to see strong customer engagement around 800G and 1.6 terabit products, particularly as AI-driven data center investments accelerate. In 2025, total revenue increased 83% compared to 2024 to a record $456 million. Data Center revenue of $196 million increased 32% compared to 2024, while our CATV revenue nearly tripled to $245 million in the same period. Additionally, we expanded our gross margins and made progress on our path to profitability. Turning to the quarter, in Q4, we delivered revenue of $134.3 million. which was in line with our guidance range of $125 million to $140 million. We recorded non-GAAP gross margin of 31.4%, which was above our guidance range of 29% to 31%. Our non-GAAP loss per share of 1 cent was narrower than our guidance range of a loss of 13 cents to a loss of 4 cents. During the quarter, we announced that we received our first 800G volume order from one of our major hyperscale customers to support its AI data center growth. This was an important milestone in our next generation data center roadmap and follows the successful qualification of our 800G products by this customer. It also reflects both the strength of our product portfolio and the deepening relationship we have with this hyperscale customer. We continue to work with this customer to finalize the firmware used in these modules to ensure interoperability across their network, which we believe will be completed in March. We have begun ramping our production of these 800G modules in anticipation of a strong volume ramp starting in Q2. Forecast demand for 800G modules are projected to exceed our production capacity through mid-2027, and we are working to add additional capacity to meet this demand. During the quarter, we saw particular strength for our 400G products with this customer, which more than offset our 800G revenue, which came in below our expectations of $4 million to $8 million, due to the ongoing firmware optimization I mentioned above. We expect continued strength in our 400G business, although 800G is expected to dominate our revenue beginning in Q2. As a reminder, our Taiwan facility was already qualified for production of several 800G product types from this Hyperscale customer during 2025. Our Texas facility was also qualified for production of some of our 800G products. During the quarter, we made advancements with qualifying additional products from our Texas facility with this customer and expect full qualification by mid-year. We expect, as we move throughout the year, to ship an increasing amount of 800G products from our Texas facility as we expand our capacity. Given the strong demand, we have continued to invest in our manufacturing capacity to support current and future demand. During the fourth quarter, we made solid progress on the production capacity ramp we outlined last year at OFC. Over the past several years, we have purposely developed and scaled automation across key elements of our production process, from laser fabrication to transceiver assembly and testing. This automation not only improves yield, but it also supports rapid scale-up with greater flexibility in terms of geographic location of production and lower geographically indexed labor costs relative to many of our competitors who rely on traditional, more labor-intensive manual operations. As we continue to bring new automated lines into production, we expect this differentiation to increasingly translate into execution strength and significant revenue expansion. As we discussed at length at OFC last year, our focus remains on scaling manufacturing capacity for our next generation transceivers, particularly 800G and 1.6 terabit products. And we remain on track with the milestones we previously discussed. As we exited the year, we neared our target of 100,000 units per month of 800G capacity, with approximately 90,000 units per month of 800G capacity at year end. with roughly 31% of that production based in the U.S. We made tangible progress during the quarter through facility expansion and equipment installation, both of which are critical steps as we prepare for higher volume production. Our

production capacity in the U.S. is currently in our existing footprint in Texas. During the fourth quarter, we announced that we signed an agreement to lease an additional building in Sugar Land. We began construction on this new facility earlier this month and are working hard to scale our production towards the middle to end of this year to achieve our 2026 targets. Looking further ahead, we expect that by the end of this year, we will be capable of producing over 500,000 pieces of 800G and 1.6 terabit products per month, with about a quarter of that output coming from Texas as we expand into additional facility space and bring new production online. These investments reflect measured scaling of our footprint while aligning with strong and growing customer demand and qualification progress across both 800G and 1.6 terabit products. Further, we have recently had dialogue with another large hyperscale customer who has been a long-term customer of ours and who is eager to begin qualification efforts for our 1.6 terabit products. This customer has also indicated a desire to purchase potentially significant quantities of 800G products from us in 2026 and 2027. We continue to discuss capacity availability and expect orders for 800G from this customer soon. It's also important to note our 800G and 1.6 terabit products can be manufactured on the same production line with the same process. While our 1.6 terabit products will require a different final testing, our 800G automated manufacturing lines have been developed with an architecture that will allow us to support future higher speed products as customer demand materializes and evolves over time. While we are encouraged by the conversations we are having with our customers pertaining to our 1.6 terabit products, We continue to believe that our 800G products will drive the near-term data center ramp, and our 1.6 terabit products are on track to begin to contribute to our overall revenue later this year. Before moving on to our fourth quarter results, I'd also like to reemphasize our in-house laser capabilities, which we believe continue to be a strategic advantage for the company. As we have mentioned before, we've been manufacturing lasers internally for many years. Having these capabilities has allowed us to avoid some of the shortages that affect others in the industry. As we continue to expand our footprint in Texas, our in-house laser manufacturing positions us well to support both near-term customer needs and longer-term growth. We believe that in the future, CPO will continue to drive increased demand for high-power lasers and plan to continue to expand our laser manufacturing capacity in Texas in order to accommodate these future growth drivers. During the fourth quarter, direct tariffs had a $1.2 million impact on our income statement. As it relates to tariffs, as I previously mentioned, while we do utilize some imported components in our transceivers, many key components, like our laser chips, are already manufactured in the United States. Importantly, in our 800G and 1.6 terabit transceiver designs, less than 10% of the value of these components used is currently sourced from China, and we have a path to further reduce that exposure to near zero that we have discussed on our prior earnings calls. Given the recent court decision on IEPA tariffs, it's worth noting that AOI acted as the importer of record for many, if not most, of the tariff shipments we incurred in 2025. Turning to our fourth quarter results, our total revenue was a record $134.3 million, which increased 34% year-over-year and increased 13% sequentially off a strong Q3 and was in line with our guidance range of $125 million to $140 million. During the fourth quarter, 56% of revenue was from data center product, 40% was from CATV products, and the remaining 4% was from FTTH, telecom, and others. In our data center business, Q4 revenue came in at $74.9 million, which was up 69% year-over-year and 70% sequentially. Sales of our 100G products increased 54% year-over-year and sales of our 400G products increased 141% year-over-year. In the fourth quarter, 51% of data center revenue was from 100G products, 41% was from 200G and 400G transceiver products, and 8% was from 10G and 40G transceiver products. In our CATV business, CATV revenue was $54 million, which was up 3% year-over-year, but was down 24% sequentially from a record Q3 and was in line with our expectations of $50 million to $55 million. Similar to the last couple of quarters, we shipped a significant quantity of 1.8 GHz amplifiers to our largest CATV customer in Q4, and demand continues to be robust. In addition to this customer, we continued to see momentum with a newer set of MSO customers that we have talked about on our prior couple of earnings calls. Looking ahead to Q1, we expect our CATV revenue will be between $61 and $67 million. Looking further ahead, the broad-based appeal of our CATV amplifiers and software solutions has been evident in these customer engagements, and we see software as an increasingly important part of our CATV offerings. Our QuantumLink software suite is designed to provide operators with enhanced remote management, visibility, and control over HFC network elements, reducing operational costs, and improving service quality. If current momentum continues, and while it is still early in the year, we still believe that it's feasible that we could generate nearly $300 million annually. While the vast majority of our

CATV revenue expectations for this year are related to our amplifiers, we do anticipate that we will generate some revenue from our software solutions this year, and we will share more on the amount and timing as we progress throughout the year. Now turning to our telecom segment. Fourth quarter revenue from our telecom products of $5.1 million was up 45% year-over-year and 37% sequentially. As we have said before, we expect telecom sales to fluctuate from quarter to quarter. For the fourth quarter, our top 10 customers represented 96% of revenue compared to 97% of revenue in Q4 of 2024. We had three greater than 10% customers, one in the CATV market, which contributed 39% of total revenue, and two in the data center market, which contributed 31% and 21% of total revenue, respectively. Of note, one of these data center customers became a 10% customer for the first time in a long time and is a US-based large hyperscale customer. In Q4, we generated non-GAAP gross margin of 31.4%, which was above the high end of our guidance range of 29% to 31% and was up from 31% in Q3 of 2025 and 28.9% in the prior year quarter. The year-over-year increase in our gross margin was driven primarily by our favorable product mix and our cost reduction efforts. Looking ahead, we expect continued gradual improvement in gross margins, although we continue to expect that the revenue mix in data center in the next few quarters will be a slight headwind. We remain committed to our long-term objective of returning non-GAAP gross margins to around 40%, and we believe that this goal is achievable as our mix shifts towards higher margin products and as we capture additional efficiencies across our operations. That margin expansion, combined with increased scale, positions us to move towards sustainable profitability, which we currently expect to achieve on a non-GAAP basis beginning in Q2 of this year. The revenue figures presented above are net of a contra revenue amount due to the accounting for warrants provided to customers. As a reminder, this amounts to approximately 2.5% of revenue derived from certain customers to whom AOI has provided warrants in exchange for future revenue. In Q4, the amount of this contra revenue was $0.73 million. Total non-GAAP operating expenses in the fourth quarter were $49.3 million, or 37% of revenue, which compared to $31.5 million, or 31% of revenue, in Q4 of the prior year, and we're in line with our expectations of $48 million to $50 million. Looking ahead, we expect non-GAAP operating expenses to be in the range of $50 million to $57 million per quarter. Non-GAAP operating loss in the fourth quarter was $7.1 million compared to an operating loss of $2.5 million in Q4 of the prior year. gap net loss for Q4 was $2 million, or a loss of $0.03 per basic share, compared with a gap net loss of $119.7 million, or a loss of $2.60 per basic share in Q4 of the prior year. On a non-gap basis, net loss for Q4 was $0.6 million, or $0.01 per share, which was narrower than our guidance range of a loss of $9 million to a loss of $2.8 million, or non-GAAP income per share in the range of a loss of 13 cents to a loss of 4 cents. This compares to a non-GAAP net loss of $1 million, or 2 cents per share, in Q4 of the prior year. The basic shares outstanding used for computing the earnings per share in Q4 were $70.3 million. Turning now to the balance sheet, We ended the fourth quarter with $216 million in total cash, cash equivalents, short-term investments, and restricted cash. This compares with $150.7 million at the end of the third quarter of 2025. We ended the fourth quarter with total debt, excluding convertible debt, of $67.3 million compared to $62 million at the end of last quarter. As of December 31, we had $183.1 million in inventory. which compared to $170.2 million at the end of Q3. The increase in inventory is primarily due to raw material purchases or increasing production. We made a total of $84 million in capital investments in the fourth quarter, which was mainly used for manufacturing capacity expansion for our 400G and 800G transceiver products. In 2025, we made a total of $209 million in capital investments, which was above the CapEx projections we gave on our Q4 call last year of $120 million to $150 million for the full year. This was primarily due to increased customer demand projections. In Q4, the direct tariff impact on capital equipment was $3.1 million. As we have mentioned before, while we would continue to do our best to minimize any impacts, Tariff rates and equipment import mix may cause future results to vary materially. Notably, we source equipment from all over the world, including from both domestic and international locations. Going forward, we believe we are well positioned for sustained growth across both our data center and CATV businesses, and the capital investments underway are expected to fundamentally strengthen the company as we execute on these opportunities. Given the recent surge in customer inquiries and apparent rising demand, we believe that by mid-2027, 100G and 400G revenue will be approximately $90 million, 800G revenue will be approximately $217 million, and 1.6 terabit revenue will be approximately $71 million monthly. Altogether, this represents $378 million in monthly revenue for transceiver products. However, we believe that the customer demand is even larger than this. In order to accommodate this expected surge in demand, we plan to more

than triple our laser manufacturing in Texas. We are evaluating our CapEx projections for 2026, and we intend to share those at a later date. Moving now to our Q1 outlook. We expect Q1 revenue to be between $150 million and $165 million. accounting for a sequential increase in CATV revenue, as well as a sequential increase in our data center revenue. We expect non-GAAP gross margin to be in the range of 29% to 31%. Non-GAAP net income is expected to be in the range of a loss of $7 million to a loss of $0.3 million, and non-GAAP earnings per share between the loss of $0.09 per share and break-even, using a weighted average basic share count of approximately 76.4 million shares. Looking more broadly at 2026, while it's still early in the year, we expect to generate over $1 billion in revenue this year, with a non-GAAP operating profit of over $120 million. This revenue level is limited by our production capacity and supply chain, not market demand, which we believe is much larger. Based on our planned capacity additions, we expect to see continued strong sequential revenue growth in the first two quarters With an acceleration in the second half of the year, as new production capacity comes online and additional customer qualifications are completed and orders begin to ship, we believe that this is an ambitious yet achievable target based upon our customers' forecasts and what we know about the unprecedented investments that are being made in AI infrastructure. With that, I will turn it back over to the operator for the Q&A session. Operator?

Conference Operator | Operator:

We will now begin the question and answer session. Again, to ask a question, you may press star then one on your telephone keypad. If you're using a speakerphone, please pick up your handset before pressing the keys. And to withdraw a question, you may press star then two. At this time, we will take our first question, which will come from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold | Analyst, Raymond James:

Thanks for taking the question. First, just a very quick clarification, if I might. I missed the value you mentioned on 800 gig revenue. I know you had a little bit of a software firmware glitch and said it was below the guided or the $4 million or so, but what was the value of 800 gig in the quarter?

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

We didn't break out exactly, but it was below $4 million.

Simon Leopold | Analyst, Raymond James:

A lot below or a little below?

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

A lot below is delayed to Q1, but we have emphasized the A&E revenue will be big in Q2 next year across the target. Our revenue in this year is $1 billion.

Simon Leopold | Analyst, Raymond James:

And I wanted to really focus on the trajectory for gross margin improvement And I wanna maybe first start with understanding how much of your laser production is in-house today versus external merchant lasers. And I guess, I appreciate that Typically, as you ramp production, there's sort of a learning curve of improving yields and things like that. So I'd like to make sure we have a good understanding of really the timeline or

trajectory to achieve that target you mentioned of 40%. So sort of where are we now and when do we, you know, what's the roadmap? Thank you.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

I think because, as I say, the gross margin for 1.6 is much, much higher than the other product. And I would say that, okay, As we say, I think by Q2, the monthly revenue, sometime in Q2, like June, July, or something like that, the revenue is like $378 million. So it depends on the portion of 1.6T transceiver. So at the time, I believe the gross margin should be 35% to 38% overall gross margin for all the transceiver revenues. So I believe we can achieve 40% growth margin by Q3 or Q4 next year.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

By the way, Simon, just to make sure you're on the same page, the revenue figures that Thompson mentioned were 2027 Q2, not this year.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

Yes, it's very important, okay? Don't be stupid.

Simon Leopold | Analyst, Raymond James:

Thank you for that, because I wrote down 26, so you anticipated my mistake.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

No one can do this kind of growth, okay? You know? It's impossible.

Simon Leopold | Analyst, Raymond James:

No, I appreciate that. No, thank you for that. And then before I pass, maybe just a quick check in on the cable TV side of the business in that it sounds like you remain very confident in the trajectory. However, the outlook offered by the big cable operators was not as inspiring. Can you sort of help folks triangulate between the CapEx forecast and your involvement in cable TV upgrades? Thank you.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Sure, Simon. I mean, I think, as we've said consistently, where the money – I mean, the overall CapEx numbers are one thing, but where the money gets spent is another thing. And I think they're spending – this year and next year, a significant amount of their spend is going towards the amplifiers, the outside plant part of the network, and that's where we play. So – There are some other parts of the network in the nodes and other things that maybe are a little slower to ramp, although I think those are also ramping pretty significantly as well. So you have to look at it on a kind of granular basis. The other thing is we've got a lot of new customers that we alluded to in the call earlier, and we'll start to see some significant contribution from those newer customers as well. So it's not just the one or two or three top largest MSOs, but also a wider swath of smaller companies that are contributing to our revenue.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

And something that you know, by end of this year, I would say more than 95% of laser will be AOI laser. Because right now there's a huge issue of laser shortage. And actually even some supplier told us, we want to get laser from them, we need to wait at least one year or even longer. So that's why we announced we will invest $300 million in Texas. The purpose, as we said, we need to triple, even more than triple, our laser magnification capacity by Q2 next year. And that's to fulfill our transceiver demand. And let me emphasize, actually, our transceiver demand is much bigger than what we projected. Right now, the number we said, the $378 million of transceiver revenue in June, July next year, okay, not this year. is limited by our capacity and the supply chain. It's not limited by the customer demand.

Simon Leopold | Analyst, Raymond James:

Thank you for taking my questions.

Conference Operator | Operator:

Thank you. And our next question will come from Michael Genovese with Rosenblatt Securities. Please go ahead.

Michael Genovese | Analyst, Rosenblatt Securities:

Great. Thanks very much. So it sounds like instead of having a steady kind of ramp on this 800G, we're expecting to come in with really big numbers starting 2Q this year and then huge numbers next year, by 2Q next year. I guess for the ramp in 2Q this year, could you just go over some of the milestones, maybe talk about the issue on the sub, but also the ongoing qualification milestones that you have to hit to kind of have that ramp in 2Q?

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Right, so as you mentioned, In order for the ramp to start in earnest, our 800G products have to be interoperable with all the different platforms that are out there at this particular customer, and there's a lot of them. So the firmware has to be modified to work with all those different platforms. So hardware-wise, everything's fine. No problem with that. Firmware is good on most of the platforms. We just have to make some tweaks to get it to work across all of the different platforms that they have. The customer and us have agreed that that should be done in the middle of next month, so a couple of weeks, three weeks from now, something like that. And then that's basically the last hurdle to kind of unleash the ramp. As we talked about, we've already started manufacturing products for that ramp. So from a manufacturing standpoint, we're gearing up. Just to touch on the beginning part of that question, too, about the kind of non-linearity of the ramp, that's because what you're seeing is our production capacity coming online, right? it's not gated by demand, it's gated by our ability to produce, and that doesn't come on in a linear fashion, right? You build a production line and you get a step function, not a smooth ramp.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

Yes. So let me emphasize, because every customer has so many different switches, so many different kinds of ASICs, and when a customer adds more switches, They always change the firmware. We are supposed to get a green light to ship out already in December last year. The delay is not our problem or whatever. It's because, you know, how come, build AI, you know, the whole system is much more complicated than before.

That's why it takes much longer. And right now, I think we feel very comfortable. And right now, I never said, okay, we have got, Almost two years of loading forecast from more than one customer, let me say that, for 800G. And right now, let me say that, more than one customer, at least two or even three, they would like to buy all the transceivers we can make for 800G 1.60 because AOI laser. And right now, it's limited by our capacity and the main power and the supply chain. So that's why we are trying everything to wrap up, but it takes time. It takes time. That's why I say, right now, this year, we say $1 billion. And let me say that demand is much, much bigger than $1 billion. But that's a number we feel comfortable. At least we feel a minimum 99% competent. We can deliver. Otherwise, the rate of risk is much bigger than that. Let me say that. Same thing for the 1.6T transceiver for June, July next year. It's still limited by supply chain. So that's a lot of issues we need to solve. And the other thing I'm going to tell you, in the short term, we should receive more than $100 million of air energy transceivers within a few months, maybe one month, two months, for sure less than three months. We should receive more than $200 million of 1.6T transceivers. All right.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Transceiver orders. We're not buying the transceivers or receiving the orders.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

We don't buy transceivers. We make the transceivers. So for sure, okay, that's how great is the market. But, you know, so many things just stop, okay? It's very complicated. The whole team is walking crazy, you know. It's a good problem. But we are working so hard. Let me say that, all right? I got it. Sounds great.

Michael Genovese | Analyst, Rosenblatt Securities:

All right. I guess, is it fair to say that it sounds, when you say demand on the 800G side is already very high, does that mean orders? I mean, do you have that level of orders already in for 800G?

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

Coming soon, at least from two customers, because they want to make sure we commit to our promise, you know. You're right on the problem, yes. They already give us the loading forecast, but to make sure we guarantee what we promise, There's some time we need to allow agreement and at the same time, for sure they'll give us order, okay? At least by end of this year or something like that.

Michael Genovese | Analyst, Rosenblatt Securities:

Okay, perfect. And last question for me. On the 500,000 units, I think you said by second quarter next year, and I think that's 800G at one point. End of this year, okay. Just the mix between Taiwan and the U.S. I mean, it sounds like you're expanding capacity in both places. Is it, I guess, harder and more expensive to do it here, which is why only a quarter of the capacity will be here? Would you prefer to have more here if it was easier? What's the decision-making on that, where to put it?

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

We don't have much longer time to spend in the U.S. I think Texas is great. I would say the best in the U.S., let me say that. But let me say that by the end of next year, I would say more than 55% would be manufactured in the U.S., or even 60% or 65% for A&G 1.60. Because that's why we're just groundbreaking.

A few weeks ago, it takes time. We need more creative, more space. It's quite expensive. And it takes time to build equipment. Then we can have equipment. Then we do qualification and training. It takes time, but it's catching up. All right? So the number will change a lot. But let me say that more than 85% of investment will be in Texas.

Michael Genovese | Analyst, Rosenblatt Securities:

Okay. Perfect. Thanks so much. Really exciting. Looking forward to following this more and to seeing you guys at OFC. Thank you.

spk00:

Thanks.

Conference Operator | Operator:

And our next question will come from George Nodder with Wolf Research. Please go ahead.

George Nodder | Analyst, Wolf Research:

Hi, guys. Thanks very much. Yeah, really impressive conversation here in terms of the demand profile. I guess I'm just curious about what you're seeing on tariffs. Obviously, we've had some moves on tariffs recently, 15% across the board tariff. I'm not sure if

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

transceivers are going to be exempt or what the situation is but can you just talk about kind of the tariff situation maybe the perception your customers have on tariffs and how that may or may not be translating into orders thanks yeah i guess there's two ways to say that first of all i mean i think anybody that's telling you they confidently know exactly what the tariff situation is going to be throughout the year is probably not being truthful i certainly don't um We have a viewpoint on the current tariffs. It's pretty much in line with where we've been in terms of tariffs. If things stay the same as they are now, I don't expect it to dramatically change the tariff picture that we outlined on the call earlier. That being said, we are looking at the options in terms of the IEPA tariffs. Those have been outlawed, so at least there's some pathway where we might be able to recoup some of those. The other thing that I've said pretty consistently, and I think it ties in with Thompson's earlier comments, while it takes a while to build capacity in the United States, the one thing I can say is the one place where I'm pretty confident in saying it's not going to be tariffed is product that's made in the U.S., and that's what we're scaling up to do. So the more, as time goes on, the more we can manufacture in the U.S. and the more that we can attract other supply chain partners, which we are doing to move their production to the U.S. as well, that will help us, you know, in the long term, that's going to be the solution for really minimizing the tariff impacts.

George Nodder | Analyst, Wolf Research:

And then the comment about recouping tariffs, I think you said you were the shipper of the record. How much could that be? What is the potential upside you guys could get if indeed you can recoup those?

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Thanks. I mean, sure, if we could recoup all of it. We had about $4.6 million, I believe, just last quarter in tariffs. We probably paid last year – $7 or $8 million in tariffs overall. You know, again, we're still analyzing exactly how many of those are IEPA-related. Not all tariffs are that way. So there's a lot of nuance there. But, I mean, you know, it's not going to dramatically change our picture, but it certainly would be a welcome cash flow development for sure. Great. Thanks, guys.

Conference Operator | Operator:

Yep. Again, if you have a question, you may press star then 1 to join the queue. Our next question will come from Ryan Koontz with Needham & Company. Please go ahead.

Ryan Koontz | Analyst, Needham & Company:

Great, thanks. Just maybe stepping back a little bit, as you think about the ramp in 400G with your large customer and 800G, which is pending, maybe can you compare kind of the production and demand view, compare and contrast between those two that gives you confidence in executing your own capacity and visibility from your customer for those two different product lines. Great, thank you.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Sure, I mean, the 400G products, as we said, are going to continue, I think there's going to be a continued strength in the sales of those products, driven by a couple of large customers, pretty much the same ones that we've already been shipping to, although we're seeing increased demand from at least one of those customers. But as we said in our prepared remarks earlier, 800G is expected to dominate those sales starting in Q2 of this year. So, you know, we'll see more revenue in 800G in Q2 than we did in 400G. And then moving through the year and into next year, I think we're going to continue to see very strong ramp in 800G because that's most closely associated with AI, right? That's the closest to the AI compute clusters, at least until we get to 1.6 terabit later this year.

Ryan Koontz | Analyst, Needham & Company:

That's helpful. And then, you know, on your laser supply, indium phosphide, you know, we were down to your facility in the fall. Where are you in terms of, you know, the equipment you need and kind of lead times with regards to expanding indium phosphide production and any color you can give us there in terms of building out your new facilities and acquiring the necessary equipment? Thank you.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

As Thompson mentioned, we're planning to triple our production of indium-phosphide-related devices here, laser devices made on indium-phosphide materials, by the middle part of next year. We have line of sight into all that equipment. It would be a very long conversation to go through every piece of equipment and what the schedule is, but the bottom line is when we talk about tripling our capacity, that includes the equipment that you either have on order or have line of sight into order that will be delivered in time to accommodate that RAM.

Ryan Koontz | Analyst, Needham & Company:

Great. Maybe just one last second. In terms of cable TV, you mentioned another customer. I assume that's a large U.S. customer. It's moving forward with 1.8 gigahertz here in terms of 4.0 ESD.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Yeah, it is. We have a number of customers. a number of customers. I would, again, I want to caution, none of those customers are as large as our largest customer, okay? But in aggregate, I think they can be a significant contributor to the revenue, which is what I was trying to outline earlier in my response to Simon's question. Great.

Ryan Koontz | Analyst, Needham & Company:

Appreciate that.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Thanks.

Conference Operator | Operator:

Yep. And our next question will come from Tim Savageau with Northland Capital Markets. Please go ahead.

Tim Savageau | Analyst, Northland Capital Markets:

Hi, good afternoon. A couple questions I wanted to follow up on. Looks like given the increase in cable in Q1, you expect data center revenues up about $10 million. I guess what's driving that if you don't expect 800 gig to ramp until Q2?

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Well, I think we're going to see two things. We'll see a growth in 400 gig. continued growth in 400 gig. And then we also do expect some revenue in 800 gig, just not, you know, the dramatic ramp that we expect to see starting in Q2.

Tim Savageau | Analyst, Northland Capital Markets:

Okay, great. So principally 400 gig. And you mentioned some, I guess, near-term gross margin headwinds driven by mix, I think you said, but you do have cable TV coverage. up in Q1, so I want to get a little more color on what's happening gross margin-wise there in Q1.

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

Yeah, as we said, at the end of the day, if you look at our guidance, it's kind of a wash in terms of gross margin. We're seeing a little bit of headwind coming from the product mix, especially 400G, as I mentioned earlier, is going to continue to grow in Q1. until later when 800G starts to take over. Meanwhile, in cable, gross margins there are better, and they're actually expanding. So that's kind of the put and take on that.

That's why it ended up being kind of a wash.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

As we said, without the real knob, 800G, we need time to fine-tune the production in the year. That's why this is early stage of volume at future 800G. That's what I say. By Q2 next year, we believe the overall gross margin will be 35% to 38% just for transceiver. By end of next year, we believe we can achieve more than 40% gross margin for all the transceiver by Q4 2027.

Tim Savageau | Analyst, Northland Capital Markets:

Okay. Maybe just one and a half more here. You mentioned expectations for 800 gig to, I guess, dominate revenue. Trying to get a sense of what that means in Q2. You should have about, you know, in the $40 million range for 100 gig, probably will be in the $40 million a quarter range for 400 gig. Would you expect 800 gig to be larger than both of those combined in Q2, or how might you frame that?

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

What we're saying is it'll be our largest segment within the data center. It'll be the largest contributor to revenue of those three, 800 gig, 100 gig, and 400 gig.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

I think it'll be more than $25 million or $30 million. As I said, the issue is the demand. The Q1, the Q4 delays due to the firmware optimization. But the Q2, Q3 is limited by our capacity. It's not a demand issue. Let me say that. As we said, we've got demand from two customers. Even, I would say we got the order from them pretty soon, within a few weeks. Then the next issue is the supply chain and our manufacturing capacity. I would say I'm very comfortable with $25 million. But customer demand could be 35 to 40 billion. So that's what we see right now. All the numbers we see here is not customer demand issue. It's AOI, manufacturer, and supply chain issue. Let me say that.

Tim Savageau | Analyst, Northland Capital Markets:

Okay, great. And I guess last question for me. You talked about the potential for a billion dollars in revenue. in calendar 26, I think, or in total. Yes. You know, I wonder, from a customer standpoint, would you, I guess, how would you expect customer concentration to look in that scenario? I know you've got a big guy on the cable side, I'm principally talking about data center. Do you think a primary customer will be half of that, or what have you?

Dr. Stephan Murray | Chief Financial Officer & Chief Strategy Officer, Applied Optoelectronics:

So if you break down the revenue, right, if you just take a round number of a billion, right, subtract the 300-ish that we have in cable TV, that gives you 700 million-ish left over. Right now, I would expect that's going to be dominated by most of that is going to be two large hyperscale customers. And they'll probably be roughly equivalent. you know, exiting the year. We'll see how that plays out. It's pretty early to say exactly how the timing on that's going to go. But I would expect at least two to be sort of comparable in size, let's put it that way. And then obviously a third one that would be, you know, smaller in scale but still significant.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

So I would say we will have three hyperscale DSNA customers be more than 10% or much more than 10% for the whole years.

Tim Savageau | Analyst, Northland Capital Markets:

Got it. Appreciate that, Collin. Thanks very much.

Conference Operator | Operator:

Yep. All right. Thank you. And at this time, we have no further questions. I'll turn the call now over to Dr. Thompson-Lund for any closing remarks.

Dr. Thompson Lin | Founder, Chairman & Chief Executive Officer, Applied Optoelectronics:

Again, thank you for joining our call today. As always, we want to extend a thank you to our investors, customers, and employees. for your continued support. We continue to believe the fundamental driver of long-term demand for our business remains robust, and we are in a unique position to deliver, to drive value from those opportunities. We look forward to seeing many of you at upcoming investor conferences as well as OFC. Thank you.

Conference Operator | Operator:

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.