NASDAQ:AAOI Q1 2026 Earnings Call Transcript

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Conference Operator | Conference Operator:

Good afternoon. I will be your conference operator. At this time, I would like to welcome everyone to Applied Optoelectronics first quarter 2026 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. Please note that this call is being recorded. I will now turn the call over to Lindsay Savarese, Investor Relations for AOI. Ms. Savarese, you may begin.

Lindsay Savarese | Investor Relations for Applied Optoelectronics:

Thank you. I'm Lindsay Savarese, Investor Relations for Applied Optoelectronics. I am pleased to welcome you to AOI's first quarter 2026 financial results conference call. After the market closed today, AOI issued a press release announcing its first quarter of 2026 financial results and provided its outlook for the second 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 Q1 results, and Stephan will provide financial details and the outlook for the second 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 second 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 to conform 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 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 21st Annual Needham Technology, Media, and Consumer Conference on Wednesday, May 13th. This discussion will be webcast live, and a link to the webcast will be available on the Investor Relations section of the AOI website. Lastly, I'd like to note

that the date of AOI's second quarter 2026 earnings call is currently scheduled for August 6, 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, and CEO:

Thank you, Lindsay, and thank you for joining our call today. We are pleased to deliver a solid first quarter result, zero in line with our expectations, driven by robust demand in both our data center and CATV business. We generated our fourth consecutive quarter of regular revenue as we executed well to expand our manufacturing capacity. We continue to see accelerating customer demands needed to support the next wave of AI infrastructure deployment. And we anticipate starting sequential revenue growth throughout these years, with a significantly larger range expected starting in Q3 as additional capacity comes online. During the first quarter, we delivered revenue of $151.1 million non-GAAP gross margin of 29.2% and non-gate loss per share of $0.07, all in line with our expected guidance range. Importantly, during the quarter, we saw and continue to see strong customer engagement around our 800G and 1.6G products, particularly as AI-driven data center investment is led. We completed our fourth volume shipment of our 800G single-mode transceiver to one of our large hyperscale customers in Q1. And we continue to anticipate a strong volume range of our 800G product starting in Q2. During the fourth quarter, we announced that we'd received our fourth volume order for our 1.6T transceiver from another long-term major hyperscale customer along with two new volume orders from this customer for our 800Z single-mode transceivers. Looking ahead, forecast demand continues to outpace our production capacity throughout mid-2027. We are working hard to add additional capacity to meet this demand. Based on new demand and our anticipated capacity range, we now believe our 2026 revenue will exceed $1.1 billion, and we now expect it to generate more than $140 million in long-term operating income in these years. With that, I will turn the call over to Stephen to review the details of our Q1 performance and our look for Q2. Stephen. Thank you, Thompson.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

As Thompson mentioned, we are pleased to deliver solid first quarter results that were in line with our expectations, driven by robust demand in both our data center and CATV businesses. We generated our fourth consecutive quarter of record revenue as we executed well to expand our manufacturing capacity. We continue to see accelerating customer demand needed to support the next wave of AI infrastructure deployment. and we anticipate solid sequential revenue growth throughout this year, with a significantly larger ramp expected starting in Q3 as additional capacity comes online. In Q1, we delivered revenue of $151.1 million, which was in line with our guidance range of $150 million to $165 million. We recorded non-GAAP gross margin of 29.2%, which was in line with our guidance range of 29% to 31%. Our non-GAAP loss per share of $0.07 was in line with our guidance range of a loss of $0.09 to break even. Notably, we continued to make progress on our key priorities in the first quarter, which included, 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 facilities. Three, diversifying our revenue base, and four, strengthening operational execution to improve our margins and long-term profitability. Importantly, during the quarter, we saw and continue to see strong customer engagement around our 800G and 1.6 terabit products, particularly as AI-driven data center investments accelerate. We completed our first volume shipment of our 800G single mode transceivers to one of our large hyperscale customers. Notably, 800G revenue in the first quarter was $4.6 million, or 5.6% of our total data center revenue. Looking ahead, we continue to anticipate a strong volume ramp of our 800G products starting in Q2. During the quarter, in line with our expectations, along with the increasing demand for our 800G products, We also saw particular strength for our 400G products. Looking ahead, we expect continued strength in our 400G business, and we expect to ship nearly four times the quantity of 800G compared to our Q1 shipments. In Q1, we announced that we received our first volume order for our 1.6 terabit transceivers from another one of our long-term major hyperscale customers. We also announced that we had received two new volume orders from this customer for our 800G single-mode transceivers. Following product qualification, we expect to begin

delivering these 800G orders in Q2, the 1.6 terabit order as early as Q3, and to complete all of the deliveries by the end of this year. This hyperscale customer has been a key and valued customer of ours for many years, and we are excited by the increased engagement and meaningful discussions we have had as this customer boosts its network bandwidth for AI workloads. We expect these orders to return this customer as a 10% plus customer for us. Looking ahead, forecast demand for 800G and 1.6 terabit modules are projected to continue to exceed our production capacity through mid-2027. we are working to add additional capacity to meet this demand. At OFC in March, we provided more color on our ambitious plans to increase our manufacturing capacity. During the first quarter, we made solid progress on this production capacity ramp, particularly for our 800G and 1.6 terabit products. As a reminder, our US manufacturing footprint is anchored in Sugar Land, just outside Houston. Through a combination of real estate acquisition and leases, we have expanded our Texas manufacturing footprint to about 900,000 square feet. This includes 135,000 square feet of existing capacity at our headquarters, two new buildings of 388,000 square feet in Pearland, Texas, a 210,000 square foot facility which is under development, and a 154,000 square foot building in Houston, Texas. For those of you who are not familiar with the Houston area, all of these facilities are located within a 15-mile radius of our current headquarters facility in Shogunate. During the quarter, we made progress building out our recently leased 210,000 square foot facility. We expect to begin initial production in this facility in the third quarter. Notably, this facility is located just a few hundred yards from our headquarters, and it will be entirely dedicated to manufacturing of 800G and 1.6 terabit transceivers. While this will not directly increase our indium phosphide wafer capacity, we plan to move the existing transceiver production from our current headquarters facility to this new building, which will allow expansion of our indium phosphide capacity. The facilities in Pearland and Houston will be built out to expand our production capacity for 800G and 1.6 terabit transceivers. We expect these facilities to come online in early 2027. As a reminder, internationally, We have 795,000 square feet across three facilities in Taiwan focused on optical transceivers, as well as a larger 1.2 million square foot facility in Ningbo, China, primarily dedicated to transceiver and cable TV manufacturing. Exiting Q1, our total manufacturing capacity approached 100,000 units per month of 800G and 1.6 terabit capacity. Looking ahead, we expect to continue to rapidly expand our production capacity to approach 150,000 per month of 800G and 1.6 terabit this quarter. As a reminder, we expect by the end of this year that we will be capable of producing over 650,000 pieces of 800G and 1.6 terabit products per month, with about 30% of that output coming from Texas as we expand into additional facility space and bring new production online. By the end of next year, 2027, we expect to grow our production capacity to be able to produce over 930,000 pieces of 800G and 1.6 terabit products per month, with over half of that output coming from Texas. These investments reflect measured scaling of our footprint while aligning with our strong and growing customer demand and qualification progress across both 800G and 1.6 terabit products. As a reminder, 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 high-speed products as customer demand materializes and evolves over time. While we continue to be 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. Our 1.6 terabit products are on track to begin to contribute to our overall revenue later this year, with the bigger ramp beginning in 2027. At OFC, we also discussed our plans to increase our manufacturing capacity for our external light source, or ELSFP, that's for co-packaged optics, or CPO. This utilizes the ultra-narrow line with high-power laser that we announced late last year. We have very limited production of these modules now, but we anticipate ramping production later this year and into 2027, ultimately culminating in about 400,000 pieces per month by the end of 2027. As a reminder, we will be making the high-power lasers for these modules for the in-house production of the ELSFP. We believe our in-house laser capabilities continue to be a strategic advantage for the company. As we have mentioned before, we've been manufacturing lasers internally for many years. This has allowed us to avoid some of the shortages that affected 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 we plan to continue to expand our laser manufacturing capacity in Texas in order to accommodate these future growth drivers. We expect to further expand our laser fabrication capacity by

around 350% by the end of 2027. A central element of our strategy is a hiring process for transceivers. which allows us to deploy production capacity where it makes the most sense economically and geopolitically while scaling output quickly, reliably, and efficiently. As I mentioned, this automation platform is also highly flexible, enabling us to produce across multiple generations, from 400G to 800G to 1.6 terabit, using many of the same techniques and equipment. In a fast-moving AI environment, that flexibility is critical. as it allows us to rapidly ramp specific products and shift production in response to changing customer demand. This capability is the result of over a decade of investment in proprietary, in-house designed equipment and tightly integrated product and process engineering. The plans that we have unveiled have been evolving for some time, so while some of the required equipment does have long lead times, we've already ordered many of the key pieces of equipment and are working closely with our vendors to ensure on-time delivery. Notably, equipment availability has not been a problem for us to date, which we believe is largely due to the fact that most of this equipment is developed in-house, which means that we're not generally in direct competition with other similar companies for supply of the necessary machinery and equipment to build our factories. There are exceptions to this, of course, but overall we feel that our in-house developed technologies give us an edge in ensuring reliable supply of production equipment. During the first quarter, Direct tariffs had a $1.4 million impact on our income statement. With the overturn of the IEPA tariffs, we have applied for a refund which we currently anticipate will be at least $5.7 million. Our application for the refund has been approved, but as the process is still very new, we currently cannot estimate the timeframe for recovery of these tariffs. Turning to our first quarter results, our total revenue was a record $151.1 million. which increased 51% year-over-year and increased 13% sequentially off a strong Q4 and was in line with our guidance range of $150 million to $165 million. During the first quarter, 54% of revenue was from our data center product, 44% was from cable TV products, and the remaining 2% was from FTTH, telecom, and others. In our data center business, Q1 revenue came in at $81.4 million, which was up 154% year over year and 9% sequentially. Sales of our 100G products increased 36% year over year, while sales for our 400G products increased tenfold year over year. In the first quarter, 41.9% of data center revenue was from 100G products, 46.7% was from 200G and 400G products, 5.6% was from 800G transceiver product, and 5.6% was from 10G and 40G transceiver product. In our CATV business, CATV revenue was $66.8 million, which was up 4% year-over-year and 24% sequentially, and was at the high end of our expectations of $61 million and $67 million. Similar to the last couple of quarters, we shipped a significant quantity of 1.8 GHz amplifiers to our largest CATV customer in Q1, and based on recent conversations with customers, we believe demand will be somewhat higher than our initial projections for 2026. We continued to see momentum with a newer set of MSO customers that we have talked about on our prior few earnings calls. Looking ahead to Q2, We expect our CATV revenue will be between $75 and $80 million. Looking further ahead, we now currently expect to generate over $325 million annually in CATV. 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. Now turning to our telecom segments. First quarter revenue from our telecom products of $2.6 million was down 13% year over year and 50% sequentially. As we have said before, we expect telecom sales to fluctuate from quarter to quarter. For the first quarter, our top 10 customers represented 98% of revenue compared to 97% of revenue in Q1 of last year. We had three greater than 10% customers, one in the CATV market, which contributed 44% of total revenue. and two in the data center market, which contributed 26% and 25% of total revenue, respectively. In Q1, we generated non-GAAP gross margin of 29.2%, which was in line with our guidance range of 29% to 31%, and compared to 31.4% in Q4 2025 and 30.7% in Q1 2025. As we discussed on our last quarterly earnings call, while we do expect continued gradual improvement in gross margins, we continue to expect that the revenue mix in data center in the short term will be a slight headwind. We remain committed to our long-term objective of returning non-GAAP gross margins to around 40% and 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 continue to expect to approach on a non-GAAP basis beginning this quarter. 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 Q1, the amount of this contract revenue was $1 million. Total non-GAAP operating expenses in the first

quarter were $51.4 million, or 34% of revenue, which compared to $35.5 million, or 36% of revenue in Q1 of the prior year, and were in line with our expectations of $50 million to $57 million. Looking ahead, we expect non-GAAP operating expenses to be in the range of $50 million to $58 million per quarter. Non-GAAP operating loss in the first quarter was $7.3 million, compared to an operating loss of $4.8 million in Q1 of the prior year. GAAP net loss for Q1 was $14.3 million, or a loss of $0.19 per basic share, compared with a GAAP net loss of $9.2 million, or a loss of $0.18 per basic share in Q1 of the prior year. On a non-GAAP basis, net loss for Q1 was $4.9 million, or $0.07 per share, which was in line with our guidance range of a loss of $7 million to a loss of $0.3 million and non-GAAP income per share in the range of a loss of $0.09 to break even. This compares to a non-GAAP net loss of $0.9 million or $0.02 per share in Q1 of the prior year. The basic shares outstanding used for computing the earnings per share in Q1 were $76 million. Turning now to the balance sheet. We ended the first quarter with $449.4 million in total cash, cash equivalents, short-term investments, and restricted cash. This compares with $216 million at the end of the fourth quarter of 2025. We ended the first quarter with total debt, excluding convertible debt, of $77 million, which compared to $67.3 million at the end of last quarter. As of March 31, we had $206.2 million in inventory, which compared to $183.1 million at the end of Q4. The increase in inventory is primarily due to raw material and work in progress needed for production, partially offset by a decrease in finished goods inventory as purchase orders to customers were fulfilled in the quarter. We made a total of $68.7 million in capital investments in the first quarter, which was mainly used for manufacturing capacity expansion for our 400G, 800G, and 1.6 terabit transceiver products. We expect to continue to make sizable CapEx investments this year as we prepare for increased 400G, 800G, and 1.6 terabit data center production. On a quarterly basis, we expect our capital expenditures to be above the total that we spent in Q1. We expect to finance these investments through a combination of cash on hand, cash generated from operations, and some equity sales along with additional debt. Notably, in Q1, we increased availability under existing and new loan agreements by $13.4 million and added another $14.5 million in April. Going forward, We believe we are well positioned for sustained growth across both our data center and CATB businesses, and the capital investments underway are expected to fundamentally strengthen the company as we execute on these opportunities. Given the rising demand, we now 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 $164 million monthly. In total, this is about $471 million per month of data center transceiver revenue, with about 40% of this capacity in the U.S. Moving now to our Q2 outlook. We expect Q2 revenue to be between $180 million and $198 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 30%. Non-GAAP net income is expected to be in the range of a loss of $2.5 million to income of $2.8 million, and non-GAAP earnings per share between the loss of 3 cents per share and earnings of 3 cents per share, using a weighted average basic share count of approximately 80.7 million shares. Looking more broadly at 2026, We now expect to generate over $1.1 billion in revenue this year, with a non-GAAP operating profit of over $140 million. As we have discussed previously, 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 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 | Conference Operator:

We will now begin the question and answer session. To ask a question, you may press star then one on your touch tone phone. If you are using a speaker phone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw the question, please press star then two. At this time, we will pause momentarily to assemble our roster. Our first question comes from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold | Analyst, Raymond James:

Thank you very much for taking the question. I wanted to dig in a little bit to understand the risk profile for ramping the capacity. I appreciate the nuance that you do a lot of your own tooling and machinery, and so that should put it in your control. I wonder if you could reflect on sort of the prior capacity expansions, what led to any kind of timing or disruption, and help us understand sort of how to prioritize the risk for meeting your schedule. And then I've got a quick follow-up.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

Sure, Simon. I think it's important to understand that the expansion that we're undergoing is while it's large in scope, it's not something that's brand new to us, right? We've built significant capacity, especially in our Asian factories over the last couple years, and now we're basically adding additional increments to that capacity, the same type of equipment, the same manufacturing process, mainly here in the U.S., here in Texas, as we talked about during the call. So from a risk standpoint, the risk of doing something that you've already done is a lot lower than doing something that's brand new, right? As we mentioned on the call, on the prepared remarks, a lot of this equipment is developed in-house, so the risk of supply chain disruptions for the equipment, I mean, it's not eliminated, right, of course, but it's a lot lower than if we were relying on the same equipment that was being bid up by, you know, other suppliers and it had limited supply to begin with, right? So, I think those two risks are minimized because of the nature of the manufacturing process that we have. It's worth noting, too, that because the process for us is very highly automated, we're not hiring a lot of people. So the labor, the risk associated with quality control issues or being able to scale labor doesn't really exist to any great extent for us as well. So it's really just a matter of can we get the equipment in and can we put it into production on time. And so far, we're executing very well to that, which isn't surprising because we've done a good job of it over the last couple of years already.

Simon Leopold | Analyst, Raymond James:

And maybe just a quick... Yeah, just a quick follow-up. I want to make sure I understand and clarify the metric you shared with us towards the end of the call, the $471 million monthly of production by the middle of 27. I want to make sure I understand, is that a... capacity number or is that a number that assumes a certain percent utilization of the total capacity available? How should we take that $471 million value? Is that a revenue forecast or is that a capacity capability and we should assume some haircut to that for lower utilization? Thank you.

Dr. Thompson Lin | Founder, Chairman, and CEO:

Simon, this is Thompson. Let's base on revenue. Actually, the actual capacity is higher. But you need to understand, when you've got the equipment, you need several months to hire people for qualification. So that means based on the order in hand or minimum commitment from the customer, plus the equipment has been fully qualified. So that means June, July, that's when we believe we can deliver. For sure, not only I think Another risk is the material. So this is why we are working with all the material suppliers to secure the material supply. That's the number we feel comfortable to commit at this moment. But if you say the actual demand could be even higher than this number, but that's the best we can do. Let me say this. The actual number for our customers is bigger. And actually, what they expect is April, not June, July. So we are still trying everything to pull it in.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

And, Simon, just to make it really clear, if you go back to our remarks in the last earnings call, that number was $378 million monthly. So that $471 is directly comparable to that, and it represents almost $100 million a month of additional revenue starting in the middle part of next year.

spk09:

Appreciate it. Thank you. You're welcome.

Conference Operator | Conference Operator:

Up next, we have George Nodder with Wolf Research. Please go ahead.

Terran Kata | Analyst, Wolf Research (on for George Miller):

Hey, guys. It's Terran Kata on for George Miller. On the ELSP business, can you talk a little bit more about the customer engagements you're seeing there? Who are you working with or how many customers are you working with? Any details would be appreciated.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

Yeah, we have a couple of large customers that we're working with.

Dr. Thompson Lin | Founder, Chairman, and CEO:

We haven't said who they are. Let me say that right now, We are working on a three-year long-term agreement with several customers, RSS3, including laser, including the ESIP. So that's the number we are talking about. That's why now in the transceiver, we are expanding very fast about our laser capacity. And right now, we have been doing a four-inch growth process. All targets go to 6-inch by end of next year. So yes, I think we need to do more investment to meet the demand for CPO market. As you know, the CPO laser is about 300 to 400 milliwatt compared to 70 milliwatt for 800G transceiver and 100 milliwatt for 1.6 terabit transceiver. the size is much bigger. Minimum maybe five times or six times bigger. That's why we need to go to maybe, that's why we already go from like two inch to three inch to four inch in the past 18 months. But we still plan to go to six inch by end of next year, including the, they will increase our capacity a lot. But at the same time, we are adding a lot of capacity, like more CBD, e-bean, stable, colder, everything.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

We see a shortage of indium phosphide laser manufacturing capacity across the industry right now, and we think that's going to persist and even get more acute with the advent of ELSFP, as Thompson mentioned. That's why we see this need to really expand our indium phosphide fabrication capability pretty dramatically over the next 12 to 18 months.

Terran Kata | Analyst, Wolf Research (on for George Miller):

Great. And then just to follow up on that, how do you see the ability to secure the substrate capacity for the indium phosphide

Dr. Thompson Lin | Founder, Chairman, and CEO:

Right now, we already got four to five suppliers. We have some kind of discussion. Sorry, not much we can say. But four of them are outside of China. So I would say right now, we should have enough inventory, minimum for almost one year. But since the volume will increase so fast, we are making calls with all the suppliers.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

I would say we've got a good line of sight into how we think we can, you know, not see a shortage there. But we can't say too much about it specifically at this point because a lot of it's under discussion still.

Terran Kata | Analyst, Wolf Research (on for George Miller):

Got it. Thank you.

Conference Operator | Conference Operator:

You're welcome. Again, if you have a question, please press star then 1. Our next question comes from Michael Genovese with Rosenblatt Securities. Please go ahead.

Michael Genovese | Analyst, Rosenblatt Securities:

Thank you. Can you give us more granularity on when you expect qualification for 800G with this hyperscaler that sounds like will be your third hyperscale 10% customer? But when in the quarter, you know, exactly do you think you'll have this qualification? And then does your guidance de-risk it, meaning that if you got it sooner or if things went to plan, would there be upside in the quarter?

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

Well, as we mentioned in our prepared remarks, we've already started shipping, so I'm not sure what the qualification question really is referring to.

Dr. Thompson Lin | Founder, Chairman, and CEO:

We have two big customers. One is qualified. Another one is almost qualified. The one gave us a rush order for, I don't remember, $140 million. I think they are negotiating with AOL with some kind of three-year long-term agreement with a very big volume. uh the qualification is pretty smooth i think we started shipping some volume in next month another customer we've been working for a long time has qualified we increase the capacity in this month on this quarter too so uh so we started shipping volume to two big customers not including a small one got it okay um and then

Michael Genovese | Analyst, Rosenblatt Securities:

You know, your guidance for the year, you're doing about a third of the revenue for the year in the first half, and then obviously expect big sequential growth in the third quarter. Then we have more big sequential growth in the fourth quarter, or is 3Q and 4Q more linear? Like, how should we think about the shape of the second half? Not linear.

Dr. Thompson Lin | Founder, Chairman, and CEO:

That is a very great question. Do I now, as I said, because, okay, let me explain to you. From the day when you order equipment and qualification, installation, everything, and some kind of reliability, even in Asia, it easily takes five to seven months. In the US, it takes another two months because of shipping. So that's why the ramping from the Q3, not Q2. Even if we've got some equipment in already, but still need to go through a lot of process, it will still take several months. So right now in Q3, we can see compared to Q2, 60% to 80% increase. Q4 should be similar. And you can figure out the number. And let me say that the actual demand is not $1.1 billion. The actual demand is $1.4 billion, $1.5 billion. So right now, our target still go to $1.2 or $1.2 billion. But we still need to work very hard, like the supply chain, 18 manpower, everything. But right now, 1.1 billion is the number we feel very competent. And it's increased from 1 billion we commit in the last quarter. But our internal number is high.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

Mike, just to summarize what Thompson said, the limiting factor for deliveries is our ability, the manufacturing capacity that we have available. So Once that capacity that we've been building, we talked in detail about the real estate that we have and the number of square feet that we've added and the equipment. Simon asked some very detailed questions about our equipment capacity and how confident we are in that. Once that starts to come online, it's not going to be a linear type of thing. It's going to be another large increment and then another large increment in Q4, as Thompson outlined. But that's why. It's not... You can't extrapolate from the first half and go, well, you know, there's only a certain growth rate. No, when you have new factories coming online, that adds capacity very quickly.

Dr. Thompson Lin | Founder, Chairman, and CEO:

And as I said, even you've got equipment, okay, it still takes easily, including my fixed cycle time, it takes at least more than three months or even longer to deliver revenue, okay, because sometimes customers need to do another on-site auditing, some kind of qualification. So we've got a lot of equipment in, But to count the real revenue, it's more like Q3. So that's what I told you. Yes, I think Q2, we have maybe 30% growth. That's limited by our capacity. But Q3, Q4, we're talking about 60, 70, or even 80% of growth in every quarter. Or actually, even Q1 next year, too. In the next few quarters, our growth will be very fast because this trend, We can't stop the feed either to the customer. Perfect.

Michael Genovese | Analyst, Rosenblatt Securities:

Great. Thank you so much.

spk09:

Appreciate the call.

Conference Operator | Conference Operator:

Our next question comes from Ryan Koontz with Needham. Please go ahead.

Ryan Koontz | Analyst, Needham & Company:

Great. Thanks. Just want to ask about, get back to the Indian classified topic here and where you are in terms of that capacity relative to your demand and, you know, the different fab equipment you need to support that growth. Can you maybe kind of walk us through some of the major milestones we should think about for the laser supply internal here, you know, over the next couple of quarters?

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

Right. Great question. So, you know, as I said earlier, I think indium phosphide capacity is critical right now. You know, the fact that we have our own in-house laser manufacturing capability is one of our key advantages. When you talk to customers, that's one of the big things that they like about it, especially now that we're seeing shortages across the industry. Our fab expansion is well underway. As Thompson mentioned, we've got a number of critical pieces of equipment, MOCVDs, coating machines, and others that are in various stages of either being delivered or being qualified. It does take a fairly extended period of time to qualify a new piece of laser manufacturing equipment, as you can imagine today. You don't want to take a risk of having an unknown quality issue there. So a lot of that is already here and already undergoing qualification or it's very close to being here. And that's why we can be pretty confident that our capacity is going to be where we need it to be. It's just a matter of going through that qualification process internally, which is, by the way, different from the transceiver qualification. Here I'm talking about our internal qualification of new equipment as it comes in.

Dr. Thompson Lin | Founder, Chairman, and CEO:

Let me say that. It's very different from transceiver. For laser, from the day you place the order to all the equipment suppliers, it takes minimum 18 months or even longer. Even right now, I think with the equipment delivery scale, it could take 21 to 24 months for you to start to deliver laser to the customer. Because sometimes the customer requires 3,000 hours or even 5,000 hours of reliability data. So we place a lot of orders to more than 50 suppliers. Let me say that. We got a commitment from the supplier, and we're getting some equipment in-house already, I think, every month. And let me say that by end of next year, we should be, I would say, minimum top three less suppliers worldwide. OK? I can't tell you how many equipment we have. It's confidential. That's why we are working with several customers, not only for transceivers, including laser, and for EOS-AP. As I said, EOS-AP is very challenging. It's very high spec and very high power, especially with wavelength control. I would say the challenge is more than 10 times. of like 70 or 80, 100 milliwatt laser for transceivers. It's totally different ballgames. That is our focus. And you know AOI has been doing the lasers since day one, including my PhD thesis, has been doing a laser since 1990. So we know how to do a good job.

Ryan Koontz | Analyst, Needham & Company:

Yeah, Professor Thompson. Yeah, thank you. If I could have a quick follow-up there in terms of your margins and how we should think about that and the mix. As your production mix of 800 moves up here, should we think about that as the tailwind for margins? Maybe can you unpack that for us just a little bit, how to think about the mix? Thank you.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

Yeah, the margins get a lot better as we expand the capacity. Right now what's going on is we're in this shifting mix between 400 and 800 and between predominantly cable TV and predominantly data center, right? So as we see that continue to shift and as 800 takes precedence, you'll start to see growth in gross margin primarily in the second half of the year.

Dr. Thompson Lin | Founder, Chairman, and CEO:

So I would say we'll go to 35% gross margin by the end of this year. And at the same time, in Q1, Q2, since we started ramping up ARNG 1.60, we need time to fine-tune the process. So the efficiency is not as good as what we expect, but I think within two, three months, I think with a fully automatic manufacturing line, we can tune out the efficiency and eat it very fast. That's the major advantage of automation. By Q3, for sure by Q4, the cost margin, the whole company should be, I would say, more than 40%, especially with the laser beams that will kick in in Q3, Q4 next year.

spk09:

That's helpful. Thank you both. All right. Yep.

Conference Operator | Conference Operator:

Again, if you have a question, please press star then one. Our next question comes from Tim Savageau with Northland Capital Markets. Please go ahead.

spk09:

Pardon me.

Tim Savageau | Analyst, Northland Capital Markets:

Hey, good afternoon. First question is trying to understand where you are capacity-wise versus what you're forecasting. So I think in the release you talked about 100,000 units a month exiting Q1 in 800 gig. And that puts your capacity revenue-wise well over $100 million, right, a quarter. We've got orders in hand for $124 million of 800 gig. The capacity, theoretically, to ship those orders And yet you're guiding to, what, $18 million, $20 million in 800 gig revenue. What I'm trying to understand is that delta and what's driving that apparent disconnect. I have a follow-up.

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

It's just timing on how long it takes to do the manufacturing process, really. Not all that $100,000 was online in the middle of the quarter, and then you add the cycle time to it. It puts the real production output for that closer to middle to even two-thirds of the way through the quarter. It's just the timing of the manufacturing lead time.

Dr. Thompson Lin | Founder, Chairman, and CEO:

So that's what I said when Simon asked why we're talking about $471 million for June, July next year. That's what I said. That is the revenue, not the capacity. The capacity is much higher because, as I said, when you have capacity, you need to add in more than one month on the official cycle time of six weeks. Plus, maybe customers need to do on-site auditing, qualification, there's all kinds of requirements. So the day you have installed, you have done all the pilot work, everything, it still would easily take another two, three, or four months to realize the revenue. Or even some of the customers even have to light some kind of light bulb, all kinds of different processes. This is why I made clear, when we're talking about $471 million in revenue, not capacity, and we're talking about equal to about $780,000 of transceivers per month by mid or next year. But actually, capacity could be high. Actually, it's high.

spk09:

Okay. Okay, got it. Yeah, I mean...

Tim Savageau | Analyst, Northland Capital Markets:

Incidentally, that would make you about the same size as Coherent after, you know, kind of a multi-year run over there. So the numbers kind of match up coincidentally.

Dr. Thompson Lin | Founder, Chairman, and CEO:

Another question.

Tim Savageau | Analyst, Northland Capital Markets:

Yeah, go ahead. Speaking of competition, earlier this week, we had a prominent contract manufacturer in the space announce two deals whereby they would be making transceivers for hyperscale customers directly. How would you assess the competitive and margin impact of that development on AOI?

Dr. Thompson Lin | Founder, Chairman, and CEO:

We don't really know, but anyway, right now I think the demand is more than what we get delivered. Let me say that. Here, we are negotiating with these three customers. The three-year number is crazy high. So it depends. Let me say that for multi-mode, it's easier. Maybe you can use Fibernet or whatever. Or even for DRA, it's easier to manufacture. But it would be very tough. for like 800G, 1.6T, 2xFR4, because you need 4 lasers. But the key is still the same thing. Can you get lasers or not? Even there are many laser transceiver suppliers. But where is the laser from? Right now, Lumentum, Coedan are completely booked, even ProCam, even Sumitomo. So without lasers, how can you make transceivers?

Tim Savageau | Analyst, Northland Capital Markets:

Got it. And last one for me. This goes back to the 1.6T comments where, Stefan, I think you talked about some revenue contribution later in the year in a bigger ramp in 27. And yet, I think it was my understanding that the big order that you announced, was that to be shipped completed in 26? Has there been some change there? Or what's the

Dr. Stephan Murray | Chief Financial Officer and Chief Strategy Officer:

No, it means that order is just a small order compared to what we're going to see in 2027.

Dr. Thompson Lin | Founder, Chairman, and CEO:

Oh, the 2027 is much, much bigger. I think the volume is light. All right.

Tim Savageau | Analyst, Northland Capital Markets:

So we've got to define our terms. $200 million is not a big ramp. Okay. I got it. Exactly.

Dr. Thompson Lin | Founder, Chairman, and CEO:

Next year, we are talking about more than $2 billion, $1.6 billion. Much more than $1.6 billion. We need to deliver in next year.

spk09:

Thanks very much.

Conference Operator | Conference Operator:

This concludes our question and answer session. I would like to turn the conference back over to Dr. Thompson Lin, founder, president, and CEO, for any closing remarks.

Dr. Thompson Lin | Founder, Chairman, and CEO:

Again, thank you for joining us today. As always, we want to extend a thank you to our investors, customers, and employees who For your continued support, this is an exciting time for our industry and for AOI. We continue to believe the fundamental driver of long-term demand for our business remains robust, and we are in a unique position to drive value from this opportunity. We look ahead to seeing many of you at upcoming investor conferences. Thank you.

Conference Operator | Conference Operator:

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