

NASDAQ:AXTI Q2 2025 Earnings Call Transcript

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Audra | Conference Coordinator:

Good afternoon, everyone, and welcome to AXT Inc's second quarter 2025 financial conference call. Leading the call today is Dr. Morris Young, Chief Executive Officer, and Gary Fisher, Chief Financial Officer. In addition, Tim Bettles, VP of Business Development, will be participating in the Q&A portion of the call. My name is Audra, and I will be your coordinator today. I would now like to turn the call over to Leslie Green, Investor Relations for AXT. Please go ahead.

Leslie Green | Investor Relations:

Thank you, Audra, and good afternoon, everyone. Before we begin, I would like to remind you that during the course of this conference call, including comments made in response to your questions, we will provide projections or make other forward-looking statements regarding, among other things, the future financial performance of the company, market conditions and trends, emerging applications using chips or devices fabricated on our substrates, our product mix, global economic and political conditions, including trade tariffs, and import and export restrictions, our ability to increase orders in succeeding quarters, to control costs and expenses, to improve manufacturing yields and efficiencies, or to utilize our manufacturing capacity. We wish to caution you that such statements deal with future events, are based on management's current expectations, and are subject to risks and uncertainties that could cause actual results or events to differ materially. In addition to the matters just listed, these uncertainties and risks include but are not limited to the financial performance of our partially owned supply chain companies, increased environmental regulations in China, and COVID-19 or other outbreaks of contagious disease. In addition to the factors just mentioned or that may be discussed in this call, we refer you to the company's periodic reports filed with the Securities and Exchange Commission. These are available online by link from our website and contain additional information on risk factors that could cause actual results to differ materially from our current expectations. This conference call will be available on our website at AXT.com through July 31st, 2026. I also want to note that shortly following the close of market today, we issued a press release reporting financial results for the second quarter of 2025. This information is available on the investor relations portion of our website at AXT.com. I would now like to turn the call over to Gary Fisher for a review of our second quarter to 2025 results. Gary?

Gary Fisher | Chief Financial Officer:

Thank you, Leslie, and good afternoon to everyone. Revenue for the second quarter of 2025 was \$18.0 million compared with \$19.4 million in the first quarter of 2025 and \$27.9 million in the second quarter of 2024. To break down our Q2 2025 revenue for you by product category, Indian phosphide was 3.6 million, primarily from pond and data center applications in China. Gallium arsenide was 6.2 million. Germanium substrates were 1.5 million. Finally, revenue from our consolidated raw material to adventure companies in Q2 was 6.7 million. In the second quarter of 2025, revenue from Asia Pacific was 90%, Europe was 9%, and North America was 1%. The top five customers generated approximately 30.9% of total revenue, and one customer was over the 10% level. Non-GAAP gross margin in the second quarter was 8.2%, reflecting a solid improvement from the prior quarter. For comparison, we reported a negative 6.1% gross margin in Q1, and a 27.6% gross margin last year in Q2 of 2024. For those who prefer to track results on a gap basis, gross margin in the second quarter was 8.0% compared with negative 6.4% in Q1 and 27.4% last year. We continue to be highly focused on driving continued improvement, including further recovery in Q3. Moving to

operating expenses, given the difficult climate, we have been working hard to hold OPEX down, Total non-GAAP operating expense in Q2 was \$7.6 million compared with \$8.5 million in Q1 and \$8.9 million in Q2 of 2024. On a GAAP basis, total operating expense in Q2 was \$8.2 million compared with \$9.0 million in Q1 and \$9.5 million in Q2 of 2024. Our non-GAAP operating loss for the second quarter of 2025 was \$6.1 million compared with a non-GAAP operating loss in Q1 of 2025 of \$9.6 million and a non-GAAP operating loss of \$1.2 million in Q2 of 2024. For reference, our GAAP operating line for the second quarter of 2025 was a loss of \$6.7 million compared with an operating loss of \$10.3 million in Q1 and an operating loss of \$1.9 million in Q2 of 2024. Non-operating other income and expense and other items below the operating line for the second quarter of 2025 was a net loss of \$0.4 million. The details can be seen in the P&L included in our press release today. For Q2 of 2025, we had a non-GAAP net loss of \$6.4 million, or 15 cents per share, and paired with a non-GAAP net loss of \$8.2 million, or 19 cents per share, in the first quarter of 2025. Non-GAAP net loss in Q2 of 2024 was \$0.8 million, or \$0.02 per share. On a GAAP basis, net loss in Q2 was \$7.0 million, or \$0.16 per share. By comparison, net loss was \$8.8 million, or \$0.20 per share in the first quarter of 2025. GAAP net loss in Q2 of 2024 was \$1.5 million, or \$0.04 per share. The weighted average basic shares outstanding in Q2 of 2025 was 43.7 million, Cash and cash equivalents and investments decreased by 3.1 million to 35.1 million as of June 30th. By comparison, at March 31st, it was 38.2 million. Depreciation and amortization in the second quarter was 2.5 million. Total stock comp was 0.6 million. Net inventory was down by approximately 300K in the second quarter to 80.1 million. This continues to be a focus for us, and we expect to bring it down further in quarters to come. Okay, this concludes the presentation of our quarterly financial results. Turning to our plan to list our subsidiary Tongmei in China on the star market in Shanghai, we've continued to keep our IPO application current. Tongmei remains in process as part of a much more selective and smaller group of prospective listings than a few years ago. While we are not insensitive to the current geopolitical environment, Tongmei is considered a Chinese company and continues to be regarded in China as a good IPO candidate. We will keep you informed of any updates. With that, I'll now turn the call over to Dr. Morris Young for a review of our business and markets. Morris.

Dr. Morris Young | Chief Executive Officer:

Thank you, Gary. And thank you to our customers and investors for your ongoing support as we navigate this unique economic environment. As Gary mentioned, our subsidy revenue increase in Q2 from the prior quarter but the increase was less than we had expected as a result of longer processing time for gallium oxide export permits, coupled with some sluggishness in the demand environment in China. That said, we made good progress in driving recovery in our gross margins, which has strong focus on our manufacturing process and efficiency. We also saw healthy growth in AI-related demand for indium phosphide substrate in China. And as a result of obtaining our first export license in June, we were able to ship initial orders of indium phosphide substrates to our customers outside of China. Since export restrictions are top of our mind for our investors, I'd like to begin there with an update, and then we will discuss our key markets. As many of you know, the China government imposed trade restrictions on export of gallium arsenide in August of 2023 and on indium phosphide in February of 2025. These regulations explicitly seek to restrict the export of materials used for military applications and require that we file an export permit for every customer orders. In our experience, we typically hear back our initial applications with 45 businesses, and repeat applications are often processed faster. With that said, we found the permitting process in Q2 for gallium arsenide to be slower than we typically see over the last two years. The delays in Q2 resulted in our being able to ship less material outside of China than we had anticipated. About half our revenue shortfall in Q2 was the result of this factor. On a positive note, the pace of permits in the month of July has improved meaningfully, mostly on small orders, but this improvement is good news, and we do expect Galleon Asset Revenue to grow sequentially. We're pleased to be granted our first permit for indium phosphide in late June, and we were able to ship nearly \$700,000 of material for our non-China backlog in indium phosphide in Q2. Although the process for indium phosphide has been a bit slower than we expected as well, we have received additional permits in July and expect to see more over the coming months. Based on the pace so far, we're taking a conservative view of the timing of larger permits in Q3. As we have mentioned previously, we don't believe that any of our indium

phosphide cells go into military applications, so we feel we are in a good position to realize millions of dollars of sales backlog once we navigate the permit process. While the recent geopolitical environment present a near-term headwind for our business. We are also taking advantage of some of the unique opportunities. The cloud and data center connectivity market in China is accelerating. And in an effort to promote innovation and reduce dependency on foreign suppliers, we're seeing a significant effort to develop domestic source of EML and silicon photonics-based lasers. We estimate that China's data center optical interconnect market is currently around one-third of the global market. However, most of the optical devices for these interconnects are sourced from outside of China, and applications for any phosphide substrate within China remain focused on Pong business only. Further, Laser manufacturers in China are developing an appreciation for the critical benefit of low EPD material in high-speed interconnect devices, both in the traditional pounds market and in the new data center market. As a result, our sales of indium phosphide within China are increasing. In Q2, we nearly doubled our revenue for indium phosphide within China and our revenue for AI-related applications in China are increasing, although the revenue base is small. And we expect to continue to grow in Q3. The trend for data center marketing in China remains small at this moment, but we expect to see significant growth over the next few years. As the POM laser providers expand their portfolio to include EML and silicon platonic solutions. Broadly speaking, we expect to grow our total indium phosphide revenue by 30% or more in Q3 as a result of growth in applications for POM, data center connectivity, and various indium phosphide-based sensors. Now turning to gallium arsenide. Demanding China was sluggish in Q2, and customers are taking a more cautious approach to ordering and holding inventory. Despite the lackluster environment, we were pleased to be able to grow our wireless business in China during the quarter with continued growth expected in Q3. As we mentioned, there's a sizable opportunity in the wireless market for which our technology and product are well suited. During Q2, we took a more measured approach to market expansion and were able to service a portion of the customer opportunity while executing effectively at modestly higher production levels. The adjustment we made in our approach, along with the strong focus from our manufacturing organization on yield and efficiency, allowed us to drive meaningful improvements in gallium oxide gross margins, which contributed to our overall progress to our gross margin recovery. This should continue to be a top priority for us in the second half of the year. Turning to Germanium business, we saw growth in our revenue in Q2 driven by satellite solar cell applications in China. This market is highly price sensitive and we continue to be very selective in the business opportunities we choose to support as the sharp rise in germanium raw material pricing in the last several years has severely constrained growth margins. In addition, germanium substrates permits for sales outside of China have been difficult to obtain. Therefore, in Q3, we expect to see our sales come down again and we may remain at lower level rate through the second half of the year. With regard to our raw material joint ventures, our consolidated revenue in Q2 declined by approximately \$1.6 million compared to Q1. The economic climate was one factor, and the other factor relates to the mix of revenue from the two service model I customly choose for our Germanium for their gallium purification process. On a positive note, the pricing environment has been relatively stable. Globally, there continues to be a greater awareness of the importance of Earth's material, and we're ahead of the curve in developing this unique and integrated supply chain. In summary, though the export permit process has been slower than we would like to be, we are making progress against the backlog of more than \$10 million in customer orders for gallium arsenide and indium phosphide substrates. We're also encouraged to see growth in strategic applications within China, including indium phosphide for AI-related data center connectivity and gallium arsenide for wireless devices. With a strong focus on gross margin improvement across our product portfolio, We delivered meaningful recovery in Q2 and expect to continue our progress in the second half of the year. Our competitive positioning continues to be enhanced by superior product performance in key specifications such as low EPD, and we're working diligently to support the next generation technology requirements of our global customer base. With that said, I will now turn the call back to Gary for our three-quarter guidance. Gary?

Gary Fisher | Chief Financial Officer:

Thank you, Morris. In keeping with our comments today, we believe Q3 revenue will grow sequentially to be in the range of \$19.0 million to \$21.0 million. This guidance range includes a modest contribution from Indian Phosphide and Gallium Arsenide for our customers outside of China and only includes revenue for which we currently have permits. Within China, we continue to optimize emerging opportunities to grow our business in strategic applications for both indium phosphide and gallium arsenide. And finally, we expect our germanium revenue to be down and our raw material business to be approximately flat in Q3 from the prior quarter. As Morris mentioned, we continue to focus strongly on gross margin improvement. In Q3, we expect our margins to improve again and to be in the low mid to mid teens. Based on this revenue range and gross margin improvement, we believe our non-GAAP net loss will be in the range of 11 to 13 cents, and GAAP net loss will be in the range of 13 to 15 cents. Share count will be approximately 43.8 million shares. Okay, this concludes our prepared comments. We'd be glad now to answer any of your questions. Audra?

Audra | Conference Coordinator:

Thank you. We will now begin the question and answer session. If you have dialed in and would like to ask a question, please press star 1 on your telephone keypad to raise your hand and join the queue. If you would like to withdraw your question, simply press star 1 again. We'll go first to Russ Cole at Needham and Company.

Russ Cole | Analyst, Needham and Company:

Hi, and thank you for taking my question. And it's great to hear that you're starting to, you know, get some of the permits, especially for indium phosphide. But I was wondering, given that there's still been a bit of a delay in the permitting, are you concerned about any potential share loss to customers if they're continuing to wait for this licensing process?

Dr. Morris Young | Chief Executive Officer:

Thank you. Yes. Tim, go ahead. Yes, sorry. Sorry, Maurice.

Tim Bettles | VP of Business Development:

Yes, I can answer to that. So in the near term, obviously, it has taken some extra time to get these permits. And the customers are working every channel they can to get material in on time. But we do continue to receive permits. And if we continue to receive permits specifically for those larger orders, we have a very healthy backlog that's ready to ship. And we believe that the market is just growing too fast to be adequately serviced by just two players at this moment. So long term, I think the business still holds good.

Dr. Morris Young | Chief Executive Officer:

Yeah, if I may add to that point, I think immunophosphide is at a critical juncture at this point, I think. You know, I think immunophosphide traditionally has been serving the faster data center activities such as transceivers. But now with AI going from 800G to 1.6T to 3.2T, as the speed goes up higher and higher, the need for ending phosphide is more, and also the requirement for lower EPD material becomes that much more important. And so not only I believe with AI's advancement in data center applications will increase the need for ending phosphide tremendously, and also because of the device size becomes larger and the power requirement for these higher speed indium phosphide devices will need better quality material. And all that

said, should increase our indium phosphide business opportunity for AXT. And with all that said, AXT is also a significant player in indium phosphide substrate supply overall. We believe we are either number one or number two in the world of Indian phosphorous substrate supply, which we estimated to be at least 40% of the world's Indian phosphorous supply. So I think although the permitting and the geopolitical restriction is hurting our business at this point, but I think the demand is there. We believe we should recover.

Russ Cole | Analyst, Needham and Company:

Great. Thank you so much. That was really helpful. And then I have another question. It looks like, you know, it's great to see your gross margin improving again. And I wanted just to confirm, I remember in the first quarter there had been a bit of a yield issue associated with germanium arsenide for a wireless HPT customer. It seems like that's been resolved. And have you, you know, resumed the business opportunity with that customer at this time?

Dr. Morris Young | Chief Executive Officer:

Yes, we have. But although we're taking, as we said in the script, we're taking a fairly conservative approach. And so we're not taking a big portion of it, but we want to not only serve the customer well, also holding our, improving our margin. So I think we should be able to continue to see the improvement throughout the second half of the year on that business. And if we can improve the margin, so that also implies better yield and efficiency, we should ask for a higher portion of our business with that customer. So that should grow our revenue as well.

Russ Cole | Analyst, Needham and Company:

Great. Thank you so much. And that's all for me.

Audra | Conference Coordinator:

Next, we'll move to Tim Savigo at Northland Capital Market.

Tim Savigo | Analyst, Northland Capital Market:

Hey, good afternoon. Sorry about that. I want to go back to something Tim said and the other Tim about the market growing too fast to be serviced by two players. And I want to kind of dig into that a little bit more. Obviously, we've got a lot of indications of that, both from what the hyperscale guys are planning to spend and what we're hearing from various members of the technology kind of ecosystem, demand seems to be pretty strong. I wonder from AXTI's perspective, you know, any more details on what you're seeing there in terms of the growth and or growth potential and whether that's, you know, how your backlog may have increased during the quarter given the export issues and how you see that playing out for the rest of the year? Were we not facing these export issues in indium phosphide? Is the growth rate that you had been looking for before, has that accelerated? What are the trends there?

Tim Bettles | VP of Business Development:

Thank you, Tim. It's a good question. I just basically want to repeat a little bit what Morris has just said. Obviously, we are seeing market trends that the demand for optical interconnectivity is growing rapidly. The move to higher speed transceivers is moving rapidly, just as we expect. This not only, we've said for a long

time now, this has a bit of a double benefit for us. because we are not only seeing that people, as we move to larger and larger, higher and higher speeds, the constraints on the lasers and detectors become higher and higher. So higher quality material is required, lower EPD material is required. So we also see some market share coming our way because of that. But in addition to that, a lot of these new devices are large. As we move into some of the larger EML devices and we move to silicon photonics, the acreage of indium phosphide that is used goes up too. So we do see the demand for indium phosphide substrates increasing very healthily, certainly at least at the growth rates that we were predicting earlier this year, and probably even higher. As Morris again said, we own about 40% market share in this. So when I say it's difficult for this market to be served by two players, we've got a quality and technology improvement over our competition. We've got 40% market share already. It's very difficult to fill that hole very quickly. We are still seeing orders, although the permit process is going slow. We're receiving new orders on pretty much a daily basis for indium phosphide. So we're definitely seeing the demand for AXT is still there. Once we start getting these orders, these permits come through, I'm sure we're going to see more demand coming our way.

Tim Savigo | Analyst, Northland Capital Market:

Okay, thanks. And then just to follow up, I think you mentioned the \$10 million backlog for both indium phosphide and gallium arsenide. And I guess looking at the shortfall in the quarter, I think you said half of that was gallium arsenide export. So should we infer from that that the majority, not the vast majority, of that backlog is indium phosphide? And, you know, without the permits, I mean, could you ship all that this quarter? Or, you know, I guess, how quickly do you think you can get back to \$10 million or get to \$10 million a quarter in indium phosphide substrate revenue?

Tim Bettles | VP of Business Development:

Right. Again, good question. Thank you, Tim. So, yes, more than 50% of backlog is indium phosphide. And We've got a large amount of capacity there right now. We're typically turning orders around in four to six weeks. Sometimes if we need to, we can turn them around faster than that. Of course, before all of this permit procedures that came into place, we've got a lot of WIP and we've built up WIP waiting to go to get some of those permits coming in as well. So it is possible that we can turn all of this backlog around pretty quickly. But of course, it's going to be very dependent on the timing that those permits come in and how they come in throughout Q3. But we do anticipate that this will, should we get more permits, we're confident we will, we'll see an upside to our Q3 guidance.

Tim Savigo | Analyst, Northland Capital Market:

Great, thanks very much.

Audra | Conference Coordinator:

We'll go next to Richard Shannon at Craig Hallam Capital Group.

Tyler Anderson | Analyst for Craig Hallam Capital Group:

Hi, this is Tyler Anderson on for Richard Shannon. Thank you for taking my questions. Could you expand upon why the gallium arsenide export licenses slowed down as the indium phosphide licenses began to be issued? And is this the same agency that's issuing these? Are you expecting any lower cadence of the indium phosphide licenses than what you expected before because of the gallium arsenide slowdown?

Tim Bettles | VP of Business Development:

Again, I can at least start so I can probably elaborate a little bit more. It's difficult for us to speculate really what is going on here. What we do know is that it is not AXT specific. The whole industry has been faced with delays with gallium arsenide permits. What we have seen, however, is that through Q3 and certainly through this past month, the permit approval process seems to be speeding up. Again, we've received quite a few more permits just in July, but I think it looks like they're now catching up through some of the backlog that we've seen there. So hopefully things will return to normal fairly soon, both on gallium arsenide, and then hopefully we'll see the same kind of cadence on indium phosphide as we approach normality on gallium arsenide.

Dr. Morris Young | Chief Executive Officer:

Yeah, I think Tim doesn't want to speculate, but I can sort of tell you if you see the news that, you know, the ongoing of the restriction of rare earths in China implementing the policy probably has something to do with it. In other words, China wants to use this as a negotiating tool. So I think they started to restrict the number of permits. But I think we are seeing that latter part of it they start to relax more now I think it's hopefully it's getting into a more regular session that they would we should be able to get more permits regularly thank you for that and are you seeing any sort of um advanced order makings where customers are starting to build inventory and could we see any kind of

Tyler Anderson | Analyst for Craig Hallam Capital Group:

spikes in your revenue moving forward as you work through the backlog and people start to place larger orders while they can get a permit?

Dr. Morris Young | Chief Executive Officer:

I would tend to think they are threatening to give us big inventory orders to anticipate getting the permits, but I don't think we are at that stage because we're not delivering even the first big, large orders. We do have a lot of very urgent order needs to be delivered. And so the customer said, OK, if we could get the first order through, they will give us the other anticipated order they want to build inventory. But I don't think we are at that stage to worry about that yet, because we're not even delivering the first batch. I mean, as far as big order is concerned. We so far delivered, we said, \$700,000 worth of any phosphide orders outside of China. But, you know, the backlog is, you know, six, seven times or even ten times that.

Tyler Anderson | Analyst for Craig Hallam Capital Group:

Awesome. Thank you. That is all of my questions.

Audra | Conference Coordinator:

And that concludes our Q&A session. I will now turn the conference back over to Leslie Green for closing remarks.

Leslie Green | Investor Relations:

Thank you all for participating in our conference call. We will be participating in the annual Needham Virtual Semiconductor and Semicap Conference in August and hope to see many of you there. And as always, please feel free to contact us if you would like to set up a call. We look forward to speaking with you in the near future. Thanks.

Audra | Conference Coordinator:

And this concludes today's conference call. Thank you for your participation. You may now disconnect.