NASDAQ:AXTI Q3 2025 Earnings Call Transcript

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Leslie Greene | VP, Investor Relations:

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, ability to obtain China export permits, the timing of receipt of export permits, 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 events or results 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 and increased environmental regulations in China. In addition to the factors just mentioned or that may be mentioned 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 October 30, 2026. I also want to note that shortly following the close of market today, we issued a press release reporting financial results for the third 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 third quarter 2025 results. Gary?

Gary Fisher | Chief Financial Officer:

Thank you, Leslie, and good afternoon to everyone. Revenue for the third quarter of 2025 was $28.0 million, compared with $18.0 million in the second quarter of 2025 and $23.6 million in the third quarter of 2024. To break down our Q3-25 revenue for you by product category, indium phosphide was $13.1 million, primarily from data center and pond applications. Gallium arsenide was $7.5 million. Germanium substrates were $640K, and revenue from our consolidated raw material joint venture companies in Q3 was $6.7 million. In the third quarter of 2025, revenue from Asia Pacific was 87%, Europe was 12%, and North America was 1%. The top five customers generated approximately 45.2% of total revenue, and two customers were over the 10% level. Non-GAAP gross margin in the third quarter improved substantially to 22.4%, reflecting improved product mix and higher volume to absorb overhead. For comparison, we reported 8.2% gross margin in Q2 of 2025 and a 24.3% gross margin in Q3 of 2024 last year. For those who prefer to track results on a GAAP basis, gross margin in the third quarter was 22.3% compared with 8.0% in Q2 of 2025 and 24.0% in Q3 of last year. We continue to be highly focused on driving continued improvement, including further recovery in Q4. Moving to operating expenses, given the difficult climate, we've been working hard to hold down OpEx. In addition, we had some favorable adjustments in R&D in Q3 that brought our OpEx down to a lower than normal level. These will not carry over into Q4. Therefore, our total non-GAAP operating expense in Q3 was $6.7 million compared with $7.6 million in Q2 and $8.3 in Q3 of 2024. On a GAAP basis, Total OpEx in Q3 was 7.3 compared with 8.2 million in Q2 and 9.1 million in Q3 of 2024. Our non-GAAP operating loss for the third quarter of 2025 improved substantially to $384,000 compared with the non-GAAP operating loss in Q2 of 2025 of 6.1 million and the non-GAAP operating loss of 2.6 million in Q3 of 2024. For reference, our GAAP operating line for the third quarter of 2025 was a loss of $1.1 million compared with an operating loss of $6.7 million in Q2 and an operating loss of $3.4 million last year in Q3. Non-operating other income and expense and other items below the operating line for the third quarter of 2025 was a net loss of $46,000. The details can be seen in the P&L included in our press release today. For Q3 2025, we had a non-GAAP net loss of $1.2 million or $0.03 per share compared to the non-GAAP net loss of $6.4 million or $0.15 per share in the second quarter of 2025. Non-GAAP net loss in Q3 of 2024 was $2.1 million or $0.05 per share. On a GAAP basis, net loss in Q3 was $1.9 million or $0.04 per share by comparison Net loss was 7.0 million, or 16 cents per share, in the second quarter of 2025. Gap net loss in Q3 of 2024 was 2.9 million, or 7 cents per share. The weighted average basic shares outstanding for Q3 2025 was 43.8 million shares. Cash and cash equivalents and investments decreased by 3.9 million to 31.2 million as of September 30th. By comparison, at June 30th, it was 35.1 million. Accounts receivable increased by 11 million, so the delta in cash is explained in working capital. Appreciation and amortization in the third quarter was 2.3 million. Total stock comp was 0.7 million. Net inventory was down by approximately 2.4 million in the third quarter to 77.7 million. This continues to be a focus, and we expect to bring it down further in quarters to come. This concludes the discussion of our quarterly financial results. Turning to our plan to list our subsidiary Tang Mei in China on the star market in Shanghai. We've continued to keep our IPO application current. Tang Mei remains in process as a part of a much more selective and smaller group of prospective listings than a few years ago. Although the current geopolitical environment is dynamic, Tang Mei 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 it over to Dr. Morris Young for review of our business and markets. Morris.

Dr. Morris Young | President & Chief Executive Officer:

Thank you, Gary. This has been a very eventful quarter for AXC, as we are seeing a strong uptick in any phosphide demand from data center applications globally. And as our industry and our customers adapt a new normal, rapidly changing environment, In Q3, our revenue grew 56% sequentially and 18% year over year. Within this, our indium phosphide revenue grew to our highest level since 2022, as we were successful in obtaining export permits for a number of significant indium phosphide orders throughout the quarter. I'm very proud of the diligence our team and grateful for the partnership of our customers in working through the export control permitting process. Our current experience is that our Indian phosphide permits are taking approximately 60 business days or approximately three months to be processed by China's Ministry of Commerce. This is a bit longer than our initial expectations, but customers are adapting to the requirements and are adjusting their ordering patterns to give us more visibility and longer lead times. I should also note that the Golden Week holiday at the beginning of October in China will likely increase the average permit processing time by a week or so in Q4. The tremendous growth in demand for Indian phosphide-based lasers and detectors for high-speed optical connectivity, coupled with our successful obtaining export permits on behalf of our customers, are driving a strong increase in our Indian phosphide order backlog, which, as of today, is more than $49 million and growing. Our established customers are planning for longer lead times, by placing longer term orders and giving us more visibility into the expected demand. We're also seeing active engagement with several new tier one customers to qualify our material into their supply chains for the first time in many years. This includes leading optical transceiver module makers, both in China and around the globe. As many of you know, The supply chain for optical transceiver is quite complex and highly globalized. We believe this geographic interdependence is providing both opportunities and incentives for the ecosystem to work together in new ways to solve global supply chain shortages. For a geographic demand perspective, the massive AI infrastructure built out and the planned CapEx spending by cloud services and AI platform providers in the United States is the primary driver for EML and silicon photonics-based optical transceivers. We believe that today our materials are being used in multiple US hyperscalers, and we expect that end customers use will continue to broaden. In China, The data center build-out is early in its ramp, but there is a strong desire for domestic suppliers at every level of the supply chain, and we believe over the next 12 to 18 months, we will see healthy growth in the China data center market. Data center expansion in China is quickly overtaking PANG as the leading application in China for our Indian phosphide substrates. Given the strong demand environment, it is important to know that AXC is well positioned to handle increased demand. We have ample manufacturing capacity in place today, and we can also significantly increase our output by current level, and we can also add capacity quickly as needed. We also have a demonstrated ability to supply very low EPD wafers in volume that meet the vigorous requirements of next-generation EML and silicon photonics-based devices. Now turning to gallium arsenide. Our revenue grew more than 20% from the prior quarter. The biggest driver was some insulating wafers for wireless RF devices, which remains a focused application for us. Industrial laser applications were about flat from Q2, and we saw an uptick in semiconducting wafers for data center laser applications. However, VIXO lasers don't typically require a lot of gallium oxide material, so they don't move the needle much as a growth driver. But they do require high quality material, which were well positioned to supply. In germanium substrates, Our sales declined by about $1 million in Q3. The remaining substrate market was very poor gross margin potential today. And while our material performed well in the solar cell applications as we supplied, gross margin constraint disincentivizes us to pursue many opportunities. In addition, Certain customers prefer to source substrates outside of China. As such, we do not expect growth in Germanium substrates in Q4. Finally, our raw material business in Q3 was consistent with the prior quarter, and it was solidly profitable within a stable pricing market. We expect the same for Q4 globally, There continues to be a greater awareness of the importance of earth materials, and we are ahead of the curve in developing this unique integrated supply chain. In closing, this is a highly active time for our business. The receipt of any phosphide and gallium arsenide export permits remains the single most significant gating factor for our growth. As such, we're highly focused on ensuring that we are proactive, organized, and disciplined about managing the process on behalf of our customers. We also know that we must be laser-focused on running our business with the greatest efficiency. This includes our continued effort to drive growth margin improvement, outback discipline, and inventory reduction. We saw ongoing market trends fueling the data center upgrade cycles, we believe we have tremendous opportunity in 2026 to drive meaningful growth in our business and a return to profitability. We look forward to reporting to you our growth progress. With that, I will turn the call back to Gary for our fourth quarter guidance. Gary? Thank you.

Gary Fisher | Chief Financial Officer:

Thank you, Morris. To reiterate a couple of key points from Morse's commentary, we are seeing a strong increase in our Indian phosphide wafer demand related to AI and the ongoing data center upgrade cycle. Given the geopolitical complexities surrounding this market trend, customer behaviors in our space are changing to allow for longer substrate lead times. Our customers are placing longer-term orders and providing greater visibility into their needs. As such, our Indian Phosphide backlog has grown to $49 million and is the largest we've ever had in our history. Further, we are actively engaging with new customers today that we've not had business with an opportunity for some time. With all of these positive market and AST-specific growth drivers, the most significant gating factor in our growth in Q4 and beyond is the success and timing of getting export permits. Therefore, guiding for the future is somewhat tricky for us right now as we cannot predict future timing of permits or our success in obtaining them for any customer or individual order. But drawing on what we know and have what we've experienced this far in the export permitting process, we can offer the following insight into our expectations for Q4. As of today, We have approximately $20 million in revenue that can be realized in Q4 across our substrate product lines and raw materials for which we either already have a permit to ship or for which an export permit is not required because it ships within China. We have a high degree of confidence in recognizing this revenue in Q4. In addition, we believe there's an incremental $7 to $10 million in Indian phosphide and gallium arsenide backlog which is currently in our manufacturing process for which we believe we may be able to ship in Q4 if we are awarded permits. Of course, timing of permits is not within our control, but we believe we are in a similar or slightly better position in terms of customer order backlog and permit submissions than we were at this same point in the prior quarter. As such, with that as background, We believe we have the capability to achieve revenue in the range of $27 to $30 million in Q4, subject to the caveats I just mentioned. This takes into consideration approximately flat sequential revenue contribution from germanium substrates and raw materials, with incremental growth in Q4 likely coming from indium phosphide and gallium arsenide substrates. As Morris mentioned, we continue to focus strongly on gross margin, We made significant gains in Q3 and continue to work on our manufacturing efficiency. Further improvement in Q4 depends on a number of factors, including total revenue as it relates to the absorption of fixed costs, revenue mixed by product, and our ability to continue to drive better manufacturing efficiency. With regards to OPEX, we expect that it will increase to approximately 9 million as a result of some incremental end-of-the-year adjustments and a return to a more normalized level. With these factors in mind, we believe our non-GAAP net loss will be in the range of one to three cents, and our GAAP net loss will be in the range of three to five cents. This represents substantial year-over-year progress towards our return to profitability. We estimate the share count for Q4 will be approximately 43.8 million shares. And okay, this concludes our prepared comments. We'll be glad to answer your questions now. Operator, Kelvin?

Operator | Conference Operator:

Ladies and gentlemen, we will now begin the question and answer session. I would like to remind everyone to ask a question. Please press the star button followed by the number one on your telephone keypad. If you would like to withdraw your question, please press star one again. One moment, please, for your first question. Your first question comes from the line of Charles Shi of Needham & Co. Please go ahead.

Charles Shi | Analyst, Needham & Co.:

Hi. Morris, Gary, congrats on receiving the licenses, the permits, shipping 8 million additional revenue in a quarter, and congrats again on the 49 million backlog. That was an exciting number to hear. Really want to get back to this point, the customer behavior change, like are they placing longer-term orders, but I think if I hear you correctly, some of those customers may not necessarily have the permits at this point and still proceeded to place the orders with you, a pretty significant amount of orders with you. Can you kind of talk through what exactly is driving that behavior and what do you think the export permits, the current ones you already have, Are there time limits to that? Are there, like, volume limits to that? And what could be your best prediction going forward from here that customer behavior can continue to evolve? Thank you.

Tim | VP, Operations:

Tim? Yeah, thank you, Charles. So we have, as you said, a $49 million backlog. That includes customers that have previously received permits. and customers that are still in their permit phase for the first permit as we go through. Everybody that has previously received a permit has typically received subsequent permits from there. So there's a lot of confidence in getting further permits as we move forward through this. So people are placing orders into that backlog with the understanding that the confidence levels of receiving permits are high, especially for indium phosphide. So as we look forward and as we look at that backlog, all of the orders that we've received and put into backlog have permit applications in place so far. And we manage that backlog and those permit applications, and we manage the manufacturing process so that we can combine the expected permit approval time with the finishing of the product. So our lead time to ship the product after receiving the permit is very low.

Dr. Morris Young | President & Chief Executive Officer:

Yeah. So maybe I can add another point. I hear Charles is asking, is there any relationship with customer giving us a lot more order, longer order lead time, is it because we have a permit process? I think that is true. People are realizing, instead of just in time, they want to give us a long lead time to submit the permit application so that we can ship this product to them in time. Is that part of the question, Charles?

Charles Shi | Analyst, Needham & Co.:

Yes. I think that may be a better way to help us understand what the permit does to the size of the orders, how much long-term the orders is going to be. Maybe you can shed some light, let's say, the order currently on average cover, is it like a one-year demand, two-year demand, three-year demand? What do you see there? Like how long does the order you have in the backlog covers what customers demand?

Tim | VP, Operations:

Right, okay, understood. Thanks, Charles. So the permit, we apply for a permit, and it can be for multiple shipments, number of shipments up to 12. This is the important part. The permit only lasts six months. So everything has to be shipped within six months of receiving the permit.

Dr. Morris Young | President & Chief Executive Officer:

Yeah, and the other point is this. Our customers are telling us, we'll give you this order. If you get the permit and if you can manufacture it, you can ship it tomorrow.

Gary Fisher | Chief Financial Officer:

So when Tim mentions up to 12, that means 12 line items. Every PO needs a separate permit. So if you put each line item on a separate PO, then we need 12 permits. Yeah. It's complicated.

Charles Shi | Analyst, Needham & Co.:

as they say in the show business. It is, it is. So maybe I ask another question on profitability. So when you were at this revenue level in the high 20s, going back a few years, you probably have a gross margin somewhere in the high 20s or even low 30s percent. and you would have a non-GAAP APS in the positive territory. But I think, Gary, if I hear you right, I think you're still expecting some GAAP, some non-GAAP loss in the coming quarter. And I wonder if there's anything, you know, cost structure that's a little bit different now versus back then. How do we get back to the similar profitability level at the similar revenue round rate back in the, let's say, only go back two or three years?

Gary Fisher | Chief Financial Officer:

Yeah, I expected to be asked that question to us. And it's something that we talk about internally. So as I like to say to ourselves and to analysts and investors, in our business model, it's never one single dial. It's not like one thing we can focus on, and we have to focus on two to four things to sort of move the needle in the right direction. In this regard, one of the things we need to get improvement on is gross margin, and that's primarily a result of mix, which is going in our favor right now, and also efficiencies on the line. So I'm actually encouraged to be able to say this because It's pretty much in our control. And we've done better than we're doing right now. But it is common in manufacturing businesses to have some cycles. And so I think we can work on that and focus on it and get improvement. That's probably the biggest one. I think we could get a bit more help from our joint venture companies. Expect that to improve in the coming quarters as well. But those are the two things that come to mind.

Dr. Morris Young | President & Chief Executive Officer:

So Charles, maybe I can answer part of the other question. I think that the deadliest thing in manufacturing, I think analysts should ask is, is your ASP dropping? Okay, I think we can say, except with the low end on the two inch in the fast wire, most of our ASP are holding very firm. In fact, some of the ASP for our high end low EPD in the phosphide substrate, their ASP is increasing. So I think we can surely stop that worry. I mean, we have some other efficiency issues, such as loading factors. You know, germanium is perhaps not making a whole lot of money for us, because the pricing pressure is very strong. But the main focus on any phosphide

spk01:

The pricing is firm and the demand is high.

Charles Shi | Analyst, Needham & Co.:

Thanks. I think maybe one last question before I jump back into the queue would be the Indian phosphide demand you're seeing today, How much of that is from the overseas customers that need a permit versus domestic Chinese customers? And if I recall correctly, I remember that the indium phosphide was primarily shifted to outside of China previously. How much of the domestic development today maybe has led to a little bit more of a domestic shipment of the indium phosphide? If you can kind of, you know, paint a little bit of picture to us of how things have been evolving, that would be great. Thank you.

Dr. Morris Young | President & Chief Executive Officer:

Well, you know, actually indium phosphide business is very globally connected. a lot of our substrates are shipped to, let's say, Taiwan to put an API on and shipped back to the United States to make a device and shipped back to China to make a transceiver and then shipped back to U.S. data centers. So I think, you know, but our direct customer in China is roughly, I would say, 40%. But the great advantage AI opportunity definitely is, you know, the big increase is in the AI data center in the United States.

Tim | VP, Operations:

I think I can add to that as well. If you look at our financials from Q2 versus Q3, you can see that the indium phosphide in Q2 was about $3.5 million, and that's increased to about $13 million in Q3. So that kind of gives you an idea of what the incremental is, and all of that incremental has come from outside of China. Thank you.

Gary Fisher | Chief Financial Officer:

Next question, please.

Operator | Conference Operator:

Your next question comes from the line of Richard Shannon of Craig Hallam. Please go ahead.

Richard Shannon | Analyst, Craig-Hallum Capital:

Well, hi, Morris, Gary, and Tim. Thanks for taking my questions, and I'll offer grads on a wonderful quarter. Great to see. So, grads to the entire team for making that happen here. Let's start with the first question here on the union classified backlog. I just want to understand the dynamics here. Maybe if you can help us understand a few things here. What was the backlog a quarter ago, and then how far out are customers ordering here? I would imagine, given one of the prior answers here, talking about a permit allows you to ship for six months, that they're probably going out six months here, but just want to get a sense of what this looks like and how it's changed.

Tim | VP, Operations:

Yeah, so as Morris has previously said, those permits do last six months, but most of our customers are asking to ship as soon as we can. So that backlog, once we have a permit, we can ship that backlog as quickly as we can manufacture, to be perfectly honest. So in terms of our backlog last quarter, we've got more than double the backlog as we speak today than we had last quarter. So, you know, that continues to grow. And as was said in the conference call, we're seeing more and more new opportunities coming. So that backlog is growing daily as we speak.

Dr. Morris Young | President & Chief Executive Officer:

Yeah. You know, maybe I can chime in a bit. You know, I think this CEO, I take care of a lot of this China development, engineering, and manufacturing, and also one of my duties is to push the IPO process in China. But recently, I got pulled in more and more to talk to customers in phosphides because they cannot get enough material. They call my sales guys and the sales guy says, well, you got to come and visit the customers to calm them down. How are we going to opening up the opportunity to supply any phosphide customers? So I got a lot of this very good, warm, receptions from our customers, and sometimes from the customer's customer, and also the end user. So in other words, the IP growers, the device makers, as well as the CPU, GPU makers. In fact, I got a message from our customers, especially globally, not especially. They all told us that we are a very important supplier of Indian phosphide. Secondly, they all told me there's a great, great opportunity to increase the demand in the near future. Obviously, they are all anxious to know what are we going to do to ease the pain of getting the permits to export material. And lastly, quite a few customers told us they start to appreciate the better EPD or the better quality of indium phosphide material we supply. In fact, one customer told me that now every dye counts, and using our substrates, they can make better dye yield on their lasers or detectors. So I think that's a very warming information for me, and also telling us that indium phosphide There's a paradigm shift because of the global increased demand for AI connectivity in optical transceivers. And what's the other word? CPOs?

Tim Savageau | Analyst, Northland Capital Markets:

CPOs.

Dr. Morris Young | President & Chief Executive Officer:

I start to learn that word.

Richard Shannon | Analyst, Craig-Hallum Capital:

Yeah. Okay. That is helpful. I'm going to explore a couple of different angles on the dynamic here. I think one of the things that investors will be worried about or cognizant of here is customers understanding the geopolitical dynamics, as you referenced in your prepared remarks, and worried about the door shutting here at any point, you know, very well could be, you know, ordering well above what their normal rates of consumption would be in building some level of inventory. To what degree do you see that behavior anywhere here in the in the backlog build, and what are the limits to your shipping faster? Are you near, you know, full utilization, near-duty classified today?

Tim | VP, Operations:

So let me start by answering the dynamic question. I think the fact of the matter is that people are building inventory levels so that they have inventory on hand. but I don't think this is a one-time build-out because they're concerned. This is a multi-year cycle. So the demand today that we're seeing is real, and you can see evidence of that all up and down the supply chain for optical transceivers. I want to really just look at some of the capex spending messaging that was given from U.S. hyperscalers on their earnings calls yesterday. So everybody is talking about CapEx moving faster and, quote, growth in dollars getting noticeably larger as we go through financial year 26. So there's definitely growth going on here at the hyperscale level, and we're seeing that come into here. We're also seeing longer-term discussions on indium phosphide for CPO. both on scale up and scale across now so the demand is there the demand is real and of course people are building backlog also people are building inventory levels but those inventory levels will continue to grow so we don't see this as a one-and-done shot yeah so let me add on to another point you know yesterday Tim and I were in the valley visiting a few

Dr. Morris Young | President & Chief Executive Officer:

actually customers' customers. They're asking me what can they help in terms of financially, in terms of customer relationship to ensure that Indian phosphorus will be supplied. In other words, they are telling me there's a tsunami coming. I just don't know how big the tsunami is because the normal rate, let's say if it is a one foot wave, then tsunami is only 10 feet. It's not that big. But if the normal wave is already 5 feet, then that's going to be very significant. So we're going to get that information soon. But I think the demand from what I hear is enormous. And don't forget, Richard, we are 40% of the Indian phosphide supply chain. And we have the best quality materials.

Gary Fisher | Chief Financial Officer:

By the way, tsunami was used by the customer that Morris and Tim were visiting. We're not making it up in our conference room. So I was struck to hear that word as a description of what's on the future.

Richard Shannon | Analyst, Craig-Hallum Capital:

Okay. Thanks for that. Now let me ask another question here looking on the other side of this dynamic here, which is you mentioned a number of engagements with customers you've not worked with ever or for a very long time here. I think, Morris, you've been talking about the very, very good EPD specs on your D5-5 for a few years at least. And we haven't heard you talk about new customers really much, if at all. And I know I've asked on this conference call a few times in the last few years on this topic. Why is it they're all of a sudden coming to you now? It seems like It's a unique or, I guess, a coincidental timing to see a number of customers coming to you at this particular time. What's going on here and what's driving that?

Dr. Morris Young | President & Chief Executive Officer:

Gee, you're so smart. I mean, you called me. But, you know, I tell you, I have a perfect answer to that. That is, first of all, I think with all these lasers getting bigger and bigger, the EPD is getting that much more efficient. Because the larger the device, the chances of you hitting an EPD is higher. In fact, yesterday, I was told by one of the customers, how come you guys can make the EPD so low? Right, Tim?

Tim | VP, Operations:

Right, right. And I think the market is maturing such as well. And the demands that our customers are being faced with, with increased demands, increased capacity, One of the customers said to us, every device is important. The yield of devices on a wafer has become so much more important today than it ever has been, both because of cost and capacity constraints within the fab. So people are turning to us because they get much higher device yields from our wafers.

Dr. Morris Young | President & Chief Executive Officer:

Yes, that's what that customer told us. Straight in the face, they wouldn't tell us because we would have to ask higher price.

Gary Fisher | Chief Financial Officer:

Richard, a secondary factor subservient to what Morris and Tim just described is there is a concern among the customer base about capacity and capacity potential. They're sensing that there's shortages, and we are the best positioned currently with capacity and with the ability to respond quickly to add capacity.

Richard Shannon | Analyst, Craig-Hallum Capital:

Well, Gary, that was a perfect setup for my next question here, which is on a full run rate basis, hand-in-mouth basis here, what is your kind of maximum Indian phosphide revenues per quarter here? And how long would it take you to get a new capacity and what kind of CapEx commitment to grow it by, I don't know, say 25%? How does that look like?

Dr. Morris Young | President & Chief Executive Officer:

Well, you know, we could double our capacity on Indian phosphide in about nine months time it would take us about my estimation is because this is our green field we got the clean room already we got your land already and all we need to do is add a few crystal boys so my estimation is about 10 to 15 million dollars but we need a signal i i'm i'm getting it

Tim | VP, Operations:

So let me answer the question on current capacity there, Richard. So it's a complex question because it depends on a number of factors relating to product mix and wafer size and inventory on hand and all that kind of stuff. But we estimate that current capacity is around about $20 million a quarter for indium phosphide with our current run rate and current capacity that we've got. You asked how quickly can we increase by 25%. Probably within about three months, we can increase by 25%. We do not need to build anything other than bring some more furnaces online.

spk01:

And to add, for us to double that, then we need nine months. I caught that.

Richard Shannon | Analyst, Craig-Hallum Capital:

That's perfect perspective. I've asked a lot of questions. I will jump in line and read you here, guys. Thank you. Thank you very much.

Operator | Conference Operator:

Your next question comes from the line of Tim Savageau, Northland Capital Markets. Please go ahead.

Tim Savageau | Analyst, Northland Capital Markets:

Hey, good afternoon. And again, congrats on that backlog number. Believe it or not, I still have a few questions. And I guess the overall question is, guys, is doubling capacity, is that a tsunami? Or is that just good business?

Dr. Morris Young | President & Chief Executive Officer:

That's a good question, but I think I'll be happily retiring when the capacity is doubled with all these better growth modules. I'm joking. I think it's a lot more than that. I think, but one step at a time. I think if we can double that, and I think we have all the ability to increase our capacity, well, the easiest way is in China. But I think beyond that, we may want to consider building something.

Tim Savageau | Analyst, Northland Capital Markets:

Yeah, US-based capacity would make a lot of sense. And yeah, I think just intuitively, a tsunami is like 5 to 10x. And I have heard numbers like that in the industry in terms of where demand is going to be. And it sounds like the tsunami reference in particular Is that a specific kind of looking forward, scale up, scale across comments, which is to say, I assume what you're seeing in terms of current demand is likely module driven, might be similarly CPO, you tell me, but in terms of the real big step function and capacity, is that discussion mostly CPO based or scale up type based?

Tim | VP, Operations:

Yeah, that's absolutely right. So we are seeing growth right now. That is, we believe, in the pluggable market and probably will continue to be in the pluggable market for the next few years. But we are starting to have those discussions now about growth rates for CPO for scale up. And the tsunami, the 510X that you talk about, That is, a lot of that is coming from CPO for scale up.

spk01:

Yeah. Yeah.

Tim | VP, Operations:

Yeah.

Tim Savageau | Analyst, Northland Capital Markets:

Makes sense. Sorry, Morris, were you saying something?

spk01:

No, I said yes. Yeah.

Tim Savageau | Analyst, Northland Capital Markets:

I like talking. The question, I'll add to the, just trying to get a sense of this backlog. So, you know, you increased your backlog. You doubled it and shipped 13 million in material. which I think gives you a book to build. It's approaching three, so that's not bad. But where would that kind of normally be, I guess? And so maybe as opposed to go back to last quarter, let's go back to last year or just historically, you know, without export, you know, permits required, what kind of backlog would you normally have in terms of, you know, quarters of revenue or just straight up, where was that indium phosphide backlog? you know, Q3-24?

Gary Fisher | Chief Financial Officer:

Well, because we could be responsive to customer orders, we had a lot of terms business every quarter. So to be honest, we don't really, in terms of me and Morris and Tim, we don't manage the company by looking at it book to bill. You know, I have in other companies, but it's not very meaningful in this case. So it's hard to say what it was because I don't have a piece of paper in front of me with that list. Because there's no such list.

Tim Savageau | Analyst, Northland Capital Markets:

Got it. Well, it sounds like it should be some fraction, you know, maybe half or a third of whatever your Indian phosphide revenue was a year ago.

Gary Fisher | Chief Financial Officer:

Yeah.

Tim Savageau | Analyst, Northland Capital Markets:

Your backlog is tsunami. It's up 10x, right?

Gary Fisher | Chief Financial Officer:

Yeah. And again, tsunami was not, I agree with you, tsunami is 5 to 10x. And I'll say again, that was not our words. That was the words from you know, an end customer.

Tim Savageau | Analyst, Northland Capital Markets:

So, uh, yep. Okay. Last one for me, um, mentioned two 10% customers in the quarter and, uh, Morris, you talked about kind of industry structure, you know, epi tier one back to the U S but, um, any color on, you know, whether you've got a, you know, an integrated device maker in there is just really focused on, EpiWave for suppliers or whether you might have a new 10% customer in there.

Tim | VP, Operations:

Dan? Yeah, so the 10% customers that we've got, we've been dealing with for a while. The new customers that we've got are integrators as well. We're dealing more and more with integrators and hardware customers.

Dr. Morris Young | President & Chief Executive Officer:

Including GPU and CPU makers.

Tim | VP, Operations:

Exactly right. So we're dealing directly with GPU, CPU hardware makers. We're dealing with pluggable makers. So that's where really the visibility is coming from.

Gary Fisher | Chief Financial Officer:

Yeah, I would say in the past we haven't had access to those people. But now they're calling us. They want to see us. So that's why we had better visibility. Yeah.

Tim Savageau | Analyst, Northland Capital Markets:

Got it. Thanks.

Operator | Conference Operator:

Your next question comes from the line of Matt Bryson of Wedbush Securities. Please go ahead.

Matt Bryson | Analyst, Wedbush Securities:

This is going to sound a little bit like a complaint, but it's not a complaint. Just curious. So there's clearly a whole lot of demand out there. Your Japanese competitor has announced two capacity increases in the last I think, four months, three months. Just curious, if you have all this backlog and your customers want more product faster, why wouldn't you be building and shipping to capacity next quarter or this quarter?

Tim | VP, Operations:

Well, all of our shipments, all of our ability to ship is based on permitting. So we, as we've talked about plenty of times, we've got a large backlog now and we can ship as we've been told by customers, we can ship as quickly as we possibly can. But we have to go through the permitting process. Now that permitting process, you know, it, it takes 60 business days, which is approximately three months. And there, there is some opaqueness to that permitting process. So, you know, If we had a bunch of permits today, I'm sure we could ship an awful lot more of that backlog today. We've guided at $27 to $30 million. If we got permits, could we ship more than that? Yes, we could. But we're basically running trend analysis on how long it takes to get permits and probability analysis of what permits we're going to get. And that's where the guidance comes in.

Dr. Morris Young | President & Chief Executive Officer:

by the way we're not standing still on those orders that we are applying for permits we are putting that into whip you know in other words we're making it and we're packaging it and waiting for the permits to to be issued and then we can deliver right away got it understood so it i mean it comes down to the permissive gating factor but as hopefully permit approvals

Matt Bryson | Analyst, Wedbush Securities:

continue to get across the line and lift, there's a path to achieving the levels of shipments that you were at a few years back during COVID. And then I guess in terms of gross margins, obviously when you're running back at close to full capacity back then, you had substantially higher gross margins, I guess what's key to getting gross margins back up? Is it predominantly utilization or were you benefiting back then from higher pricing? Can you just talk to kind of the dynamics around gross margins, where they can go to from here if you can get indium phosphide back up to full utilization?

Gary Fisher | Chief Financial Officer:

Yeah. Pricing is not really a big factor. I think the big factor is volume because it does carry more of the fixed assets in a proper way. And then I'm confident we can return. We're going to be over 30% because we can control that. So we need to improve the efficiencies on the line. but I already commented on that. So I see it going in that direction. Thanks.

Dr. Morris Young | President & Chief Executive Officer:

And again, I think the most important factor is we got more, we can utilize our Indian phosphorus line. I think that's the greatest opportunity we're facing now.

Matt Bryson | Analyst, Wedbush Securities:

Got it. Understood, Morris. Thanks. Thanks, Matt.

Operator | Conference Operator:

Next question. Once again, ladies and gentlemen, if you would like to ask a question, press the star button, followed by the number one on your telephone keypad. There are no further questions at this time. And with that, I will turn the call back to Leslie Greene for closing remarks. Please go ahead.

Leslie Greene | VP, Investor Relations:

Thank you, everyone, for participating in our conference call. We will be participating in the Northland Virtual Conference in December and the Needham Growth Conference in January, and we hope to see many of you there. As always, feel free to reach out to any one of us if you would like to set up a call, and we look forward to speaking with you in the near future.

Operator | Conference Operator:

Ladies and gentlemen, this concludes today's call. We thank you for participating. You may now disconnect.