NASDAQ:AXTI Q2 2026 Earnings Call Transcript

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Kenneth | Conference Call Coordinator:

Good afternoon, everyone, and welcome to AXT's second quarter 2026 financial conference call. Leading the call today is Dr. Morris Young, Chief Executive Officer and Gary Fischer, 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 Kenneth and I will be your coordinator today. I would now like to turn the call over to Leslie Green, Investor Relations for AXT.

Leslie Green | Investor Relations:

Thank you, Kenneth, 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, ability to obtain China export permits, timing of receipt of export permits, and list our subsidiary, Tong Mei, in Hong Kong, 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 events and 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 that may be discussed on 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 30, 2027. Also, I want to note that shortly following the close of the market today, we issued a press release reporting financial results for the second quarter of 2026 This information is available on the investor relations portion of our website. I would now like to turn the call over to Gary Fischer for a review of our second quarter 2026 results. Gary?

Gary Fischer | Chief Financial Officer:

Thank you, Leslie, and good afternoon to everyone. Our Q2 financial results highlight an exciting inflection in our business trajectory and the beginnings of a multi-year growth phase for AXT. Revenue for the second quarter of 2026 is $47.6 million. This is the highest quarterly revenue in AXT's history, up nearly 77% from $26.9 million in the first quarter and up 164% from $18.0 million in the second quarter of 2025. To break down our Q2 2026 revenue for you by product category, Indian Phosphide was $30.7 million. also the highest in our company's history. Let me repeat that. Indian Phosphide was $30.7 million, also the highest in our company's history, primarily from data center applications. Gallium arsenide was $6.6 million. Germanium substrates were $272K. Finally, revenue from our consolidated raw material joint venture companies in Q2 was $10.0 million. The top five customers generated approximately 30% of total revenue and no customers were over the 10% level. Gross margin showed a substantial improvement again in the second quarter, primarily driven by an increase in total volume and a favorable product mix. Non-GAAP gross margin was 45.0% compared with 29.9% gross margin in Q1 of 2026 and 8.2% gross margin in Q2 of 2025. For those who prefer to track results on a GAAP basis, Gross margin in the second quarter was 44.9% compared with 29.6% in Q1 and 8.0% in Q2 of 2025. This is a huge, huge positive change from Q1 of 2025. Moving to operating expenses. Our total non-GAAP operating expense in Q2 was $10.2 million compared with $8.6 million in Q1 and $7.6 million in Q2 of 2025. On a GAAP basis, total operating expense in Q2 was 10.9 million compared with 9.6 in Q1 and 8.2 in Q2 of last year. Our non-GAAP operating profit for the second quarter of 2026 is 11.2 million compared with a non-GAAP operating loss in Q1 of $550,000 and a non-GAAP operating loss of 6.1 million in Q2 of 2025. For reference, our GAAP operating line for the second quarter of 2026 was a

Leslie Green | Investor Relations:

and Kenneth.

Kenneth | Conference Call Coordinator:

Hello, Leslie. You disappeared for a second. You're back now.

Leslie Green | Investor Relations:

Okay. Great. Terrific. Continue, Gary.

Gary Fischer | Chief Financial Officer:

Am I just on the speaker on the cell phone now? Can you hear me okay?

Kenneth | Conference Call Coordinator:

Loud and clear. You can continue.

Gary Fischer | Chief Financial Officer:

Okay. For the benefit of the people listening, it's afternoon. We're in China right now, and we're at the conference room of the Tongmei headquarters, so we have a little bit of a hiccup on the phone equipment. All right. Non-GAAP operating profit for the second quarter of 2026 was $11.2 million, compared with a non-GAAP operating loss in Q1 of 2026 of $550K and a non-GAAP operating loss of $6.1 million in Q2 of 2025. for reference, our GAAP operating line for the second quarter of 2026 was a profit of 10.4 million compared with an operating loss of 1.6 million in Q1 and an operating loss of 6.7 million in Q2 of 2025. Non-operating other income and expense and other items below the operating line for the second quarter of 2026 was a net profit of 705,000. The details can be seen in the P&L included in our press release today. In Q2, 2026, we return the company to profitability. We are pleased to report a non-GAAP net profit of 11.9 million or 19 cents per diluted share. This compares with the non-GAAP net loss of 585K or one cent per share loss in the first quarter and the non-GAAP net loss in Q2 of 2025 of 6.4 million or 15 cents per share loss. On a GAAP basis, net profit in Q2 is 11.1 million or 17 cents per diluted share. By comparison, net loss was 1.6 million or 3 cents per share in the first quarter and a gap net loss in Q2 of last year of 7.0 million. The weighted average diluted shares outstanding in Q2 is 63.5 million. Cash, cash equivalents and investments increased by $625.6 million to 748.8 million as of June 30th. This was primarily the result of our secondary public offering of common stock, which closed on April 22nd and generated approximately $632 million before expenses. By comparison, at March 31st, our cash was $123 million. Accounts receivable increased by $4.7 million. During Q2, we signed long-term supply agreements with Casella and Coherent Under the terms of these agreements, we receive prepayments for wafers of $22.3 million and $25.4 million, respectively. These type of agreements with significant upfront cash are an additional signpost regarding the important use of indium phosphide for high-speed optical data transmission required in AI data centers. Morris is going to talk more about this in a moment. These prepayments are posted on our financial statements as a liability and they will be converted to revenue and the liability reduces as we ship product against these agreements. Depreciation and amortization in the second quarter was 2.5 million. Total stock comp was 0.8 million. Net inventory was up approximately 6.2 million in the second quarter to 96.3 million. And this concludes our report on financial numbers. Turning to our plan to list our subsidiary Tang Mei in China, on June 26, Tang Mei notified the Stock Exchange that it was moving its applications for an initial public offering on the Star Market. This was accepted in July. AXT and Tang Mei will now instead transfer our efforts towards listing on the Hong Kong Exchange, which will likely take about a year to complete. We continue to believe that an IPO in China is a highly beneficial in expanding our capacity in China and the most efficient and effective way to support the rapidly evolving AI infrastructure build-out. This concludes our China development of its semiconductor supply chain to meet increased China-based demand for Indian fossilized substrates. Tang Mei's move to the Hong Kong Stock Exchange creates a redemption right for the $49 million invested by the PE funds back in 2021. However, we've been in discussion with them and currently they all wish to continue their investment and not be redeemed. We have sufficient cash to redeem investments should they be requested. With that, I'll turn the call over to Dr. Morris Young for a review of our business and markets. Morris. Thank you, Gary.

Dr. Morris Young | Chief Executive Officer:

This is an incredibly exciting time for AXC. As Gary mentioned, we have reached an inflection point in our business where the customer demand is extremely strong for our immune phosphate material. We are committed to doubling our immune phosphate capacity in 2026, and I'm pleased to report that we are ahead of the schedule in that effort. But more importantly, I can now report to you that our revenue opportunity for Indian Phosphine is on track to more than triple by the end of 2026, with continuous significant expansion expected in 2027. This is happening as a result of three factors. First, we're being able to expand capacity at a faster rate than we expected. Second, we're making significant strides in driving our manufacturing productivity with new crystal rose furnace designs and increase our output. And third, our customers are moving to larger diameter substrates and higher value products, resulting in favorable pricing trends. The combination of these factors is driving a step function increase in our revenue in Q2. We recorded our highest quarterly revenue and highest Indian phosphate revenue in our history with a backlog that continues to grow and now is well over $100 million. Customer demand continues to outpace supply no matter how fast we add capacity. Broadly, the deployment of optical connectivity in AI data center is accelerating as hydroscalers scale GPU dense architectures and look for higher speed, lower power photonics to move data more efficiently. In the near term, we're seeing high demand from the industry migration to 800G and 1.6G transceivers modules, for which in the phosphate-based lasers and detectors are essential for higher-performance optical links. Longer-term, hyperscalers are advancing towards near-packaged and co-packaged optics, which will continue to drive increasing demand for our material. Overall, these trends point to a durable, long-term build-out of denser optical infrastructure and a multi-year demand cycle for our indium phosphide. As many of you are aware, the competitive landscape for high quality neophosphate is limited to just a few players due to primarily the very high technical barrier to entry. Among our peers, we believe AXC is the strongest position to increase manufacturing capacity quickly and at a scale and quality needed to move the needle in our industry. and meet our customers requirements. Our team in China has done an outstanding job in bringing up new lines in our existing facilities as well as innovating to drive higher productivity. In working closely with our direct customers as well as our major end customers to understand their expected demand and roadmaps, were well into the planning process to double our capacity again in 2027 in an adjacent location. This will make AXC by far the largest in the phosphide producer in the world. In addition to growing our manufacturing footprint, we have also made great strides in development of our six inch in the phosphide capability. are exponentially more difficult to produce in volume than three or four inch wafers. And I'm very pleased and proud of our team's progress towards this new offering. I also want to thank our customers who have partnered with us throughout this process. We're excited to support them as we move forward with our own capability. Partnership is a cornerstone of our business philosophy through which we have been able to deliver game-changing innovation. This dates back to the formation of joint ventures that today make up a unique and vertically integrated supply chain. and in the last 10 years, our work with two globally recognized Indian Phosphorite customers helped us to raise the bar even further our manufacturing and business processes to be able to support the rigorous standard of some of the most prestigious companies in the world. Strong partnership lifts innovation and enables both partners to achieve more. That is why one of the most rewarding aspects of our unfolding chapter in our history is the extent to which we have been able to partner with leading customers around the world who are defining the next generation of data center connectivity. We recently signed strategic long-term supply agreement with Casella and Coherence. and this week we're very pleased to announce an agreement with Lumentin. These agreements deepens our relationship with these important customers working shoulder to shoulder with them to help them deliver on their own vision and roadmaps. In addition, they gave us the even greater sense of conviction that our capacity build-out is merited and necessary. From a geographic perspective, the massive AI infrastructure build-out and the planned capacity capex surrounded by cloud services and AI platform providers in the US is the primary driver for EML and silicon photonics-based optical transceivers. as well as high-speed photo detectors. We believe that today our materials are being used in multiple U.S. hyperscalers. We expect that end-customer use will continue to broaden. We're also seeing huge growth in China as China moves to accelerate its capability throughout the AI supply chain. Our revenue related to any phosphate-based lasers market in China more than doubled in Q2 from the acquired quarter. And we expect continued strong growth in Q3. This highlights China's increasing investment in AI infrastructure supply chain for the global market. This is a great opportunity for AFC as there's no permit required to ship our product within China. turn into gallium arsenide. In Q2, demand for semiconducting wafers for industrial robotics and data center laser applications grew sequentially from the prior quarter. We also continue to see demand for semi-insulating wafers for wireless RF devices and believe that we have a strong opportunity for market share expansion. Finally, Our raw material business continues to be highly strategic to our growth plan and also generated record third quarter revenue in Q2. As we reported last quarter, our subsidiary, Jing Mei, is now refining high purity Indian, which gives us direct control of a guaranteed supply of yet another critical material for our Indian phosphorus substrates. We're also investing to help Jingmei to expand their capabilities so that when AXC's demand for polymaterial grows, Jingmei will continue to provide a meaningful portion of our raw material requirements. Globally, there continues to be a great awareness of the importance of our raw material supply chain, and we are decades ahead of the Curves in Developing our Unique Integrated Supply Chain. We will continue to invest in our portfolio as we believe it is a major competitive differentiator. Now in summary, we believe AXC is entering one of the most consequential chapters in our company history. The investment we are making today in capacity, in technology, and in our unique integrated supply chain, position us to meet the extraordinary demand we see building across the optical and AI infrastructure markets. Our customer engagement is deepening, our visibility is improving, and our competitive differentiation is strong. While we remain disciplined, and thoughtful in our execution. We're confident that the groundwork we are laying now will enable transformational growth in the years to come. With that, I turn the call back to Gary for third quarter guidance. Gary?

Gary Fischer | Chief Financial Officer:

Thank you, Morris. As of today, we have approximately 66 million in revenue that can be realized in Q3. 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. So 66 million. We have a high degree of confidence in recognizing this revenue. We could see upside, even significant upside to this number in Q3 should we receive permits for additional orders for which we have the inventory to support. But we do not want to stress, but we do want to stress that we cannot predict the future timing of permits or success in obtaining them for any specific customer or individual order. We have delivered strong gross margin improvement over the past several quarters. Further improvement depends on a number of factors, including total revenue as it relates to the revenue mixed by product, absorption of fixed costs, and our ability to continue to drive better manufacturing efficiency. With regards to OpEx, we expect that it will be approximately 10.5 million in Q3 on a non-GAAP basis and approximately 11 million on a GAAP basis. With these factors in mind, we believe our non-GAAP net income will be in the range of 30 to 32 cents and GAAP net income in the range of 29 to 31 cents. We estimate share count for Q3 will be approximately 66.5 million shares. Okay, this concludes our prepared comments. We're glad to answer your questions now. Kenneth?

Kenneth | Conference Call Coordinator:

Thank you so much. We will now begin the question and answer session. Please limit yourself to one question and one follow-up. If you would like to ask a question, please press star 1 on your telephone keypad. To withdraw your question, press star 1 again. Please pick up your handset when asking a question. If you are muted locally, please remember to unmute your device. Please stand by while we compile the Q&A roster. Your first question comes from the line of Tim Savageau from Northland Capital Markets. Tim, your line is open. Please go ahead.

Tim Savageau | Analyst, Northland Capital Markets:

Hey, well, good afternoon from here, at least. And wow, congrats on the results and the guide. My first question is about the comments on the call about, I guess, an increased target for Thank you very much. Am I right to thinking the new sort of target exiting the years is something in the neighborhood of 60 million in the phosphide capacity? And I'll follow up from there.

Tim Bettles | VP of Business Development:

Yeah, that's about right, Tim. That's exactly what we're looking at here. So that's about $60 million there, thereabouts.

Tim Savageau | Analyst, Northland Capital Markets:

Great. Good answer. And then you're looking to double that. still, I guess, exiting calendar 27. So just confirmation on that. And then around the Lumentum deal, I wonder if you could, obviously you've got larger prepays, a longer term. I wonder if you could speak to maybe the overall size of that opportunity from a baseline standpoint or upside or however you want to talk about it. Thanks and congrats again.

Tim Bettles | VP of Business Development:

Thank you, Tim. So yeah, next year we're looking at doubling slightly more than doubling again, take our revenue to somewhere in the region about $130 million a quarter exiting the year. Yeah. Thank you about the the Lumentum deal. Clearly we've got some prepayments on that, but we're not discussing the total revenue impact of that deal at this moment.

Tim Savageau | Analyst, Northland Capital Markets:

Okay, thanks. I'll pass it along.

Dr. Morris Young | Chief Executive Officer:

Yeah. So maybe let me add one point about the capacity expansion. We are planning at least to double next year. But as you know, this target changes when, in fact, I think this year we're going to more than double. And it's because customer demand is just mounting. So we are finding, you know, whatever way to increase that capacity expansion. Although, so I'm saying although we are planning for double next year, but depends about how the business develops in the second quarter, we could find the other way to even better than that. Okay, that's my sort of in a way it's a moving target, but we think it's going to be more than double in 2027.

Gary Fischer | Chief Financial Officer:

The demand is moving faster than we can move. We're doing great to move fast, but the demand is even stronger.

Tim Savageau | Analyst, Northland Capital Markets:

Okay. not much faster, but you guys are moving pretty fast. But okay, thanks. Appreciate it.

Kenneth | Conference Call Coordinator:

Your next question comes from the line of Matt Bryson with Wedbush Securities. Matt, your line is open. Please go ahead.

Matt Bryson | Analyst, Wedbush Securities:

Thanks for taking my question and congrats on the resulting guide. just when, obviously, you're having a whole lot more success in getting permits. And it seems like with the coherent deal, have to have certainty that you're going to get permits to ship out China given given the terms of that deal. I guess we talk about how the process is changed. And about how you have more confidence in getting these permits or what has changed?

Tim Bettles | VP of Business Development:

Yeah, sure. Thanks, Matt. You know, permits always remain a bit of an issue on the back of our minds. As Gary mentioned, it's not something that we can absolutely predict both the timing and the certainty of. But we are seeing more regularity in the process, especially in certain geographic regions. So that's, you know, that's great news. And we're seeing increased demand in those geographic regions, too. So we're we're focusing now, even with greater intensity on capacity and allocation. But yeah, right now, the permits, as I say, we're seeing will see more regularity in certain geographic regions. And we're driving more and more permit applications through the Ministry of Commerce.

Matt Bryson | Analyst, Wedbush Securities:

Awesome. That's really helpful. Second question, Gary. MyMath has gross margins staying relatively stable in Q3. Is that roughly the right way to think about things? and I guess as part of that, is there any more, given how tight Indian Phosphide seems, is there any more room for price appreciation in our models?

Gary Fischer | Chief Financial Officer:

Well, it is, you know, a moving target. And of course, you know, I know you guys are going to quote to me that I would always say, okay, you can go to 35%. but that's not management's target. Management's target is a number that begins with four. I'm delighted that we got here as fast as we did. I think I would recommend stick close to what we're at right now. But I have to say again, management's target is better than that. And let's see what we can do. There's, you know, when you add more volume, that helps. on your gross margin because the fixed costs get absorbed over more units. And also when you add more volume in manufacturing business, you get better at it. So we're just experiencing a lot of positive influences right now to push this over 40%. And stay at 45% for now, but put your seatbelts on.

Dr. Morris Young | Chief Executive Officer:

Well, I can't help myself, but make a comment. You know, I'm a CEO, but I know my member, okay? Look, everybody knows our Indian Phosphorite business has better margin than the other two businesses, the gallium oxide and JVs, okay? As we grow for next quarter, it's obviously all the growth happening in Indian Phosphorite. So just by simple math, The growth margins could be better.

Gary Fischer | Chief Financial Officer:

Right, because the sales of any phosphate is increasing, and the other stuff is not increasing as fast. So we're optimistic. That's right. Yeah, but we try and be conservative on this kind of a discussion.

Tim Bettles | VP of Business Development:

Yeah, I want to add another point as well. The market is moving to larger diameters here too. We're seeing a migration from two inch to three inch, three inch to four inch. And of course, now there's a big push towards six inch for the future. This gives us a great opportunity to increase our gross margins.

Dr. Morris Young | Chief Executive Officer:

Yeah, let's not spend all the bullets, but let me give you another one because the demand is so strong. The whole eating fast food line is fully utilized. Let me give you an example. In the past, some of the smaller diameter two-inch, they are not in favor, so they are not sold out. And the big demand is on three-inch. Now, because the demand is so strong, the customer are forced or they want everything. So whatever we can produce, we can sell. That also will help us in terms of margin.

Matt Bryson | Analyst, Wedbush Securities:

all of that answers my question. Thank you so much.

Kenneth | Conference Call Coordinator:

Your next question comes from the line of Richard Shannon with Craig Callum. Richard, your line is open. Please go ahead.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Well, hi guys. Thanks for taking my questions and I'll add congratulations on an excellent quarter. Keep up the great work here.

Charles Xu | Analyst, Needham:

I guess my first question is,

Richard Shannon | Analyst, Craig-Hallum Capital Group:

The language you used for the backlog maybe was slightly different, but you used the same number of 100 million. I think you're just saying a lot more than 100 million. I wonder if you could clarify that number any more and then specifically comment how much of your calendar 27 is covered by backlog.

Gary Fischer | Chief Financial Officer:

I'm going to let Tim answer that. So go ahead, Tim.

Tim Bettles | VP of Business Development:

Yeah, I don't want to go into a lot of details about how big exactly our backlog is, but I can tell you that it is growing, and I can tell you it continues to grow, even as we ship more material. So demand just completely outpaces our ability to increase capacity, even though we've increased capacity, or we're about to increase capacity 3x this year, just simply can't keep up with it. So Backlog continues to grow, as I say, beyond $100 million right now. In terms of 2027, yeah, we're covered with Backlog going out into 2027. Obviously, a lot of our customers, if we could deliver the majority of that today, they would take it today. But that does cover going out into 2027. And of course, we have these long-term supply agreements. that take us out into 2027 and beyond as well. So we've got a lot of next year and beyond covered with LTSAs and even in some cases backlog.

Dr. Morris Young | Chief Executive Officer:

Look, I think the other answer why we're not giving out the backlog perhaps is that we are not taking orders if customer wants to place the order. We are looking at whether we can deliver because once we take the order, we're going to put them on the production queue. Right now, it's full. So it's difficult to know how much the backlog is. In fact, I think if we open up the floodgate, it's going to be huge. So we're not counting on it. And as far as 2027 is concerned, I think if we want to sign up a lot of, well, team is working on other long term supply agreement. But that doesn't mean that 2027 is all spoken off. That is, we are measuring how much we're expanding, how much we want to sign up for long term supply agreement. And some of them we want to reserve for, you know, customers coming in. So I think right now order is not a problem. Mostly is how fast we can grow.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Okay, I appreciate that perspective. A couple more questions for me. I'll jump on the line here. The next one is on D&D Phosphide here, and specifically, how much of that was shipped into China versus the rest of the world? And how do you see that going over the next, say, couple of years or so? And I ask this because you've obviously signed up an agreement with a Chinese laser company, but then also two North

American-based laser companies here. and while I'm sure those aren't the only customers you're going to have for Indian Phosphide here, I'd love to get a sense of how this ratio changes over time. Kind of what's the peak from China and what do you see as kind of that long term stable share between China and the rest of the world?

Tim Bettles | VP of Business Development:

That's a great question, Richard. So there's certainly a lot of market opportunity in China right now. As we've said, we're doubling our capacity, actually tripling our capacity in 2026. And China is definitely taking some of that capacity as we move forward. What we're seeing with the permits and with the demand globally, this is a global market, remember, we are seeing growth across all sectors. So China right now is definitely above 50% of our revenue in Q2. I would anticipate that we would see a revenue split moving forward somewhere in that 40 to 60 range as we build up both capacity and we build up long-term supply agreements both within China and throughout the rest of the world. So yeah, I would kind of model that as China being 40% to 60% of our revenue.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Okay. Thanks for that, Tim. And last question for me is on the topic of gross margins. I know there was a previous question on this topic. I'm going to ask the question slightly different, Gary, which is, you know, and I think even Morris commented today, and we've heard this many times in the past, we're going to classify it as a positive mixed dynamic and only seemingly getting better given the pricing comments you've mentioned here. but also we're going to see from your capacity expansion some depreciation costs here. And so we'd love to get a sense of from the number you just reported in the second quarter, which is utterly fantastic, how much more can it go? Can you get to a number that starts with a five?

Gary Fischer | Chief Financial Officer:

Well, let's see. Can we get there? uh it would be a record for us that's for sure but yes uh further increases in volume and improvements in productivity as well as continued favorable mix moving towards larger diameter substrates um we we should definitely be be targeting a number that begins with the five but i don't want you to Richard okay

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Let us get there first. That's fine. I won't. I just want to know what, you know, we all think of these.

Gary Fischer | Chief Financial Officer:

Don't race us to the finish line.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

I won't, and I never have, Gary. I just want to understand how close to the asymptote we are.

Gary Fischer | Chief Financial Officer:

You've been with us for a long time to cover us, and obviously this is, as Morris said, sort of more than an inflection point. This is a huge step up. So, so we're, you know, we'll try and be as specific and accurate as we can. But it's, it's, it's moving pretty fast. So, yeah, we want to be careful what we tell you. So, but yeah, we're going to target something at the end of the file. So.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Understood. Makes sense. And that's all the questions for me. Thank you. Thanks, Rishi. Kenneth, next.

Kenneth | Conference Call Coordinator:

Your next question comes from the line of Charles Xu with Needham. Charles, your line is open. Please go ahead.

Charles Xu | Analyst, Needham:

Hi. Good morning. I guess you guys are in China right now. So the first question I have regarding the capacity exiting the year, raising from basically 35 per quarter, 35 million per quarter to 60 and the next year basically raising from 17 million per quarter to 130 million per quarter. Are those numbers correct? And I think previously on the previous capacity numbers you plan to spend, well, I'm looking at my numbers, 14 million CapEx this year, 100 million CapEx next year. Do you, what's the new CapEx number? Because it does look like the, The capacity growth has upsized a lot. I want to get some thoughts on CapEx. Thank you.

Tim Bettles | VP of Business Development:

Yeah, thanks, Charles. So the capacity is growing faster than we thought, certainly in terms of revenue. That comes out from a number of factors, as Morris said. We've been able to accelerate the actual physical capacity that we have here. We are moving to larger diameter substrates, which of course helps the revenue. And we're seeing greater productivity. As Gary mentioned, moving to larger and larger volumes increases the productivity of the facility. We've seen this time and time again. So part of the capacity increase that we're seeing here isn't just a CapEx spend, but it's a productivity and a product mix change here. And that's what's really allowing us to grow the revenue quicker than we anticipated. So there's a lot going on here. Now, when you're looking at CapEx spend to get this additional capacity, there is actually not a lot of additional capex spend here. You know, as I said, as we're gaining capacity through other factors rather than just hardware deployment, it means that we can gain capacity without huge additional capex spend on that.

Charles Xu | Analyst, Needham:

Okay, so basically it sounds like they are reaffirming the the CAPEX plan you previously communicated. Is that right? That's correct.

Gary Fischer | Chief Financial Officer:

That's correct.

Charles Xu | Analyst, Needham:

Okay. Okay. The second question, once again, on backlog, you know, Morris, I understand what you said. You only want to book the order. That's what I heard. You only want to book the order. Only a booked order can be put in backlog when you you can commit to ship to the customers given that you are probably still trying to catch up with the demand by increasing supply. 100 million plus backlog, but I think I'm looking at you're already shipping 30 plus million. This quarter looks like implied for September quarter, you probably will be able to ship a 50 million I wonder if you can, you know, give us a little bit more, how much more than 100 million you actually can see, because it sounds a little bit too low to me that your backlog only covers a little bit over two quarters of the next two quarters of the expected in your falsified revenue at the implied Q3 run rate. So want to get some thoughts, what exactly is your visibility now? and why don't you book more orders and we would like to see maybe the backlog can be a little bit higher than what you just communicated. Thank you.

Tim Bettles | VP of Business Development:

Yeah, the backlog, as I say, we're not giving actual backlog numbers out here. I can say that it's well over 100 million. It exceeds two quarters for sure. I just don't want to give out too much information about that at this time. And the backlog is also covered with a lot of long-term supply agreements that are in place. There's a lot of commitment going out well beyond two quarters, both in terms of backlog and long-term supply agreements. So I really don't worry that this is a short-term thing. And remember, a lot of this backlog here is a course, is a factor of the permits as we wait for permits. And it doesn't include a lot of the China business. So we can turn the China business a lot quicker than we can turn the permitting business. As Gary said, permits are certainly getting freer, they're getting quicker, but it still takes time to apply for a permit. and we cannot apply for a permit without an order in place.

Dr. Morris Young | Chief Executive Officer:

So let me comment on the backlog issue. The backlog, when our visibility was not good, then usually it's only one quarter or maybe two quarters issue. But right now, visibility is so good that it extends out three or four quarters. So it's not a fair comparison in a way. and the other thing is that we are actually, honestly, we're not taking orders. When customers give us their demand, we look at what we can, you know, plan the production capacity will be and talk to customers about, okay, you can place this order because we have now planned capacity to accommodate this order. But beyond that, we are not taking orders. The backlog can be much bigger if we take all the orders, but then we're not expanding our capacity. So why are we taking an order? You understand what I'm saying? So it doesn't make any sense to give you, oh, we could have $150 million back order. It's not the same measure anymore.

Charles Xu | Analyst, Needham:

Got it. So, Morris, just to clarify, backlog is not that quote unquote issue. I think you've proven that's not an issue. Just want to clarify on that. But, okay, maybe a third question I have, maybe a technology question, maybe for Morris. Morris, you guys also have a pretty strong Galleon Austinized profit line. And I'm sure you've heard about, for potential use of Vixo for scale-up rather than use indium phosphide for scale-up. It's a shorter distance, and Vixo probably has some advantages there. And I wonder if you have any customer discussion around Vixo, around maybe supplying them the gallium austenite substrates there, and how are any of the conversations going so far? Thank you.

Dr. Morris Young | Chief Executive Officer:

Yeah, we have customers in China who are developing VIXO solutions. And in fact, that is a U.S. customer also talking to us about using Galleon Assay for VIXO solutions, correct?

Tim Bettles | VP of Business Development:

Yeah, correct. We're currently a supplier to Galleon Arsenal VIXOs for two large data center companies, laser companies. So yeah, we do have some visibility out there. And we are seeing that these technologies coexist, right? So the people that are deploying gallium arsenide Vixels are also very, very strongly focused on indium phosphide as well. I'm seeing more focus on the indium phosphide side of the business than the Vixels. But as I say, the VIXL technology has been out there for a long time and I don't see it going away. I see in Indian phosphide lasers, silicon photonics and gallium arsenide based VIXLs coexisting in this marketplace.

Dr. Morris Young | Chief Executive Officer:

So from what I understand, looks like the speed is the killer or is in favor of the Indian phosphide. I think it's more difficult to reach 200G, both in terms of laser emitter as well as detectors. So when you go to 200G, it has to be indium phosphide detectors and also indium phosphide laser work better. Well, I am in favor of indium phosphide for sure. The reason is that indium phosphide, we got more margins out of the this supply chain, and we are a dominant player in the classifying. So that's the answer.

Charles Xu | Analyst, Needham:

Yeah, thanks, Maurice and Tim for the insight. Thank you. Appreciate the answers.

Kenneth | Conference Call Coordinator:

We have another question from Tim Savageau from Northland Capital Markets. Tim, your line is open. Please go ahead.

Tim Savageau | Analyst, Northland Capital Markets:

Hey, thanks for the follow-up. wanted to kind of stick with that one question, one follow-up thing before. I suppose that's somewhat of an outlier. But the question is, and maybe this sort of syncs up with your China commentary, to what extent were the new deals, long-term supply agreements you've announced in recent weeks, contributors either to the Q2 results or Q3 guide or do we have a fair bit of that in front of us?

Tim Bettles | VP of Business Development:

That's a great question, Tim. The latter is the answer. We have a fair bit of that in front of us. We're supplying materials to back up those long-term supply agreements to get qualified and get ready for them. So they don't move the needle too much on Q2. We're going to see a bigger impact in Q3. and then we're going to see further growth moving out through Q4 and into next year and beyond.

Dr. Morris Young | Chief Executive Officer:

And the Casella deal.

Tim Bettles | VP of Business Development:

Great.

Dr. Morris Young | Chief Executive Officer:

Doesn't start until 2027.

Gary Fischer | Chief Financial Officer:

Right. That's a good point. That's not even happening right now in terms of that contract, even though we are selling stuff to them, but.

Tim Savageau | Analyst, Northland Capital Markets:

Great. I probably shouldn't have known that, but anyway, I appreciate that. Cheers.

Kenneth | Conference Call Coordinator:

There are no further questions at this time. I will now turn the call back to Leslie Greene for closing remarks.

Leslie Green | Investor Relations:

Thank you for participating in our conference call. We will be participating in the Needham Virtual Investor Conference in August and the B. Reilly Securities Consumer and TMT Conference in September, and we hope to see many of you there. As always, feel free to contact us if you'd like to set up a call, and we look forward to speaking with you in the near future.

Kenneth | Conference Call Coordinator:

This concludes today's call. Thank you for attending. You may now disconnect.