NASDAQ:VICR Q3 2026 Earnings Call Transcript

Generated on 11/25/2026

Operator | Conference Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the third quarter 2026 BICOR Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker's presentation, there will be a question and answer session. And to ask a question during this session, you would need to press star 11 on your telephone. You will then hear an automated message advising your hand is raised. And to withdraw your question, please press star 11 again. Please be advised that today's conference is being recorded. I would now like to turn the conference over to Jim Schmidt, Chief Financial Officer. Please go ahead.

Jim Schmidt | Chief Financial Officer:

Thank you. Good morning and welcome to Vicor Corporation's earnings call for the third quarter ended September 30, 2026. I'm Jim Schmidt, Chief Financial Officer, and I'm in Andover with Patrizio Vinciarelli, Chief Executive Officer, and Phil Davies, Corporate Vice President, Global Sales and Marketing. Earlier this morning, we issued a press release summarizing our financial results for the three and nine months ended September 30, 2026. This press release has been posted on the Investor Relations page of our website, www.vicorpower.com. We also filed a Form 8-K today related to the issuance of this press release. I remind listeners this conference call is being recorded and is the copyrighted property of I-Corps Corporation. I also remind you various remarks we make during this call may constitute forward looking statements for purposes of the safe harbor provisions under the Private Securities Litigation Reform Act of 1995. Except for historical information contained in this call, the matters discussed on this call, including any statements regarding current and planned products, current and potential customers, potential market opportunities, expected events and announcements, and our capacity expansion, as well as management's expectations for sales growth, spending, and profitability, are forward-looking statements involving risk and uncertainties. In light of these risks and uncertainties, we can offer no assurance that any forward-looking statement will, in fact, prove to be correct. Actual results may differ materially from those explicitly set forth in or implied by any of our remarks today. The risks and uncertainties we face are discussed in Item 1A of our 2025 Form 10-K, which we filed with the SEC on March 2, 2026. This document is available via the EDGAR system on the SEC's website. Please note the information provided during this conference call is accurate only as of today, Tuesday, October 20, 2026. VICOR undertakes no obligation to update any statements, including forward-looking statements, made during this call, and you should not rely upon such statements after the conclusion of this call. A webcast replay of today's call will be available shortly on the Investor Relations page of our website. I'll now turn to a review of our Q3 financial performance, after which Phil will review recent market developments, and Patrizio, Phil, and I will take your questions. In my remarks, I will focus mostly on the sequential quarterly changes for P&L and balance sheet items, and refer you to our press release or our upcoming Forum 10Q for additional information. As stated in today's press release, BICOR recorded product and royalty revenue for the third quarter of $197.1 million, up 37.5% sequentially from the second quarter of 2026, total of $143.4 million, and up 78.5% from the third quarter of 2025, total of $110.4 million. Advanced product revenue, which includes royalty revenue, increased 47.5% sequentially to $138.9 million, and Brick Products revenue increased 18.4% sequentially to $58.3 million. Royalty revenue increased 119.1% sequentially to $66.6 million. A fraction of this increase, due to initial royalty payments from the new licensee, was non-recurring. As we add more licensees, growth in royalty revenues will be less lumpy. Shipments to stocking distributors increased 24.8% sequentially and increased 16.2% year over year. Exports for the second quarter decreased sequentially as a percentage of total revenue to approximately 36.1% from the prior quarter's 46%. For Q3, Advanced product share of total revenue increased to 70.4%, compared to

65.7% for the second quarter of 2026, with Brent product share correspondingly decreasing to 29.6% of total revenue. Turning to Q3 gross margin, we recorded a consolidated gross profit margin of 68.3%, a 1,030 basis point increase from the prior quarter, Q3 gross margin increased 1,080 basis points from the same quarter last year. Gross margin improved both as a result of increased royalty revenue as well as better product gross margins as we achieved gains in volume, efficiency, and mix. I'll now turn to Q3 operating expenses. Total operating expense increased 29.6% sequentially from the second quarter of 2026 to $62.5 million. within operating expense, legal expense, a substantial portion of which is contingent on royalty revenue increased by approximately $11.1 million from the second quarter to $16.1 million. On a run rate basis, we expect legal expense to average approximately 20% of royalty revenue in the near term. The amounts of total equity-based compensation expense for Q3 included in cost of goods, SG&A and R&D was $1,203,000, $2,655,000 and $1,483,000 respectively, totaling approximately $5.3 million. Turning to income taxes, we recorded a tax provision for Q3 of approximately $15.4 million, representing an effective tax rate for the quarter of 19.6%. Net income for Q3 totaled $63.3 million. GAAP diluted income per share was $1.33, based on a fully diluted share count of 47,609,000 shares. Turning to our cash flow and balance sheet, cash and cash equivalents totaled $513.1 million at Q3, an increase of $59.6 million sequentially. Accounts receivable net of reserves totaled $102.5 million at quarter end, with DSOs for trade receivables at 34 days. Inventories net of reserves increased 6.2% sequentially to $110.9 million. Annualized inventory turns were 2.3. Cash flow provided by operating activities totaled $69.7 million for the quarter. Capital expenditures for Q3 totaled $16.1 million. We ended the quarter with a construction in progress balance primarily for manufacturing equipment of approximately $26.4 million and with approximately $48.6 million remaining to be spent. I'll now address bookings and backlog. Q3 book to bill came in above one and one year backlog increased 7% from the prior quarter closing at $406 million. 2026 is the year in which Vicor's innovative products and technology licensing practice came into focus within the industry. With incremental capacity, we expect a 10% increase in Q4 product revenue and at least $43 million in royalty revenue, assuming no new license agreements are closed this quarter. To achieve the product revenue growth objective, We are expecting another double-digit sequential increase in product revenue in our advanced products portfolio. In Q3, we achieved operating ratios for both profitability and expense approaching our long-term financial model.

Phil Davies | Corporate Vice President, Global Sales and Marketing:

Further revenue growth will result in further margin expansion. Phil? Thank you, Jim. Demand across our main business segments and in our IP licensing practice is strong. with $100 million in bookings in the first two weeks of Q4, which included a large order for second generation VPD modules from our lead customer. The purchase of two sites for ChipFab 2 and ChipFab 3 reflects the need to expand capacity in support of increased demand. Substantial capacity expansion will be necessary based on AI industry trends, and customer enthusiasm for our second generation VPD. Meetings held with major hyperscalers and OEMs at last week's Open Compute confirmed that first generation VPD systems using VRs, which infringe VICO patents, are struggling to keep up with the requirements of next generation AI systems. Our targeted audience was impressed by Veiko's second-generation VPD with its distinct manufacturability and performance advantages. Open Compute this year focused on 800-volt DC rack distribution through inefficient intermediate bus voltages from 12 volts to 6 volts or possibly 1.8 volts to a point of load approaching 0.5 volts, underscoring the inherent limitations of VRs and IVRs. Lack of adequate current density and current gain at the point of load sets the stage for broader adoption of Vico's second-generation VPD, providing high current density and much higher current gain. With its transient performance eliminating voltage undershoots, Vico proprietary All-FPA enables a 10% to 15% reduction in AI processor power loss, with over 40 times the current gain of IVRs and three times the current density of VRs. Demo systems for second generation VPD and all FPA have been set up in our Silicon Valley Applications Laboratory and are available for selected OEM and hyperscaler engagements. On the licensing front, we granted our first VPD license to a leading AI OEM based on Stage 2 unit royalty rates and responded to inquiries from two hyperscalers seeking all-inclusive licenses, quoted at Stage 2 and Stage 3 prior to the recent ITC decision to investigate VPD infringement. Even though leading OEMs have already obtained a license to our VPD

patents, others may not have yet realized that they are importing are planning to import infringing products. Catching their attention, VICO has requested the ITC to issue a limited exclusion order barring importation of unlicensed computing systems that infringe VICO's VPD, like the ITC did before in an earlier investigation involving our NBM patents. As hyperscalers and other OEMs come to realize the impact of an importation ban, They will take licenses based on escalating royalty rates established in our licensing practice, which favors early adopters. The decision to focus on a set of top 100 customers and top channel accounts or TCAs with our global distribution partners across our four markets and four regions globally is clearly playing off with both bookings and opportunity pipeline growth. Our customers are on the cutting edge of high growth applications with the toughest power delivery challenges and specifications. Our leading ATE customers for ASIC and memory test systems, which now represents over $100 million in annual revenues, shows no signs of slowing down. And we are actively discussing capacity reservations to ensure supply in coming years. Major new product introductions are also underway in our industrial and aerospace and defense businesses with market expansion now occurring with new non-traditional companies that have entered the A&D market with new autonomous technologies. Successful execution is achieved with focus and we are very focused. Thank you and we will now take your questions.

Operator | Conference Operator:

Thank you and as a reminder to ask a question please press star 1 1 on your telephone and wait for your name to be announced and to withdraw your question please press star 1 1 again and the first question is going to come from Quinn Bolton with Needham and Company. Your line is open.

Quinn Bolton | Analyst, Needham & Company:

Hey guys, congratulations on the strong product and licensing outlook. I guess I wanted to start, Jim, just you'd mentioned that the royalty revenue in the third quarter of $66.6 million did include some catch-up royalties. Wondering if you could help size that in the third quarter, and then I've got a couple of follow-ups.

Jim Schmidt | Chief Financial Officer:

It might be best to just think about the $43 million that I mentioned, Quinn, as the baseline amount that we can count on now with no new deals. as a starting point for Q4. Got it.

Patrizio Vinciarelli | Chief Executive Officer:

So thinking about this, what's the meaning of non-recurring? I think that which was labeled non-recurring has been recurring pretty periodically, right? So as we pointed out, in Q3, there was a contribution There is no recurring, but then, you know, early in Q4, we get some other contribution. So I think we should all expect that our licensing income is going to be growing while we're still in a licensing arrangement with a relatively small subset of of all the hyperscalers and OEMs. It is still going to be lumpy. There's going to be more, quote-unquote, no recurring contributions. It's not going to be until there's a crossing of the chasm with respect to the need to license microtechnology for freedom to operate in applications given the strong component of... Quentin, I'll just add to what Patrizio said. It's better for, I think, the audience and the analysts to think about the royalty stream as recurring.

Jim Schmidt | Chief Financial Officer:

And not a non-recurring activity, just to put it in perspective. The nature of the agreements are recurring.

Quinn Bolton | Analyst, Needham & Company:

Got it. Yeah, no, I think, you know, understand that if you sign new licenses, there may be, you know, catch-ups with those additional license agreements, but the $43 million sounds like a good go-forward base, and then obviously we can add on to that as the company signs new licenses. I wanted to turn to the second and third chip fab. I think we're all expecting you to announce a second site, so it was great to see you announced by the second and the third site. Can you give us a sense for the second site? When would you think that that facility would come online and begin contributing to product revenue? Is that a sort of 12-month timeline? Is it 18 months? What's a good sort of timeline for investors to be thinking about with that second site?

Patrizio Vinciarelli | Chief Executive Officer:

We're likely going to have some initial equipment deployment in Q2 of 27.

Quinn Bolton | Analyst, Needham & Company:

And would that be able to produce sort of full set or is that just first equipment deliveries, Patrizio?

Patrizio Vinciarelli | Chief Executive Officer:

Yeah, so it's going to be incremental steps with respect to those processes where we first ran into capacity limitations in Fab 1. So in Fab 2, we're going to bring up lines that address the shorter term limiting factors and move on from those to other ones.

Quinn Bolton | Analyst, Needham & Company:

So it may not be sort of full production, a mimic of Fab One, but you'll bring in those production steps where you're most constrained. So the impact would be to increase the company's total manufacturing beginning the second quarter.

Patrizio Vinciarelli | Chief Executive Officer:

That's right. Yeah, obviously, for those process steps, while we still have ample capacity at Federal Street, there is no need, there is no rush. to deploy additional equipment there. So we're going to be able to do it incrementally and more cost effectively and more predictably.

Quinn Bolton | Analyst, Needham & Company:

Got it. And then the last one for me, Phil, you mentioned good meetings at Open Compute. Last week, and just kind of wondering if you could address what kind of demand are you seeing for the factorized power or the 48 core solutions as the VRs and IVRs do look increasingly challenged? When do you think you might see sort of adoption of a second-gen VPD outside of your lead customer based on some of those conversations?

Phil Davies | Corporate Vice President, Global Sales and Marketing:

So conversations are still early, Quinn, in that regard. We do have line of sight to new chips that are under development that are sort of further out, if you like. But I do think that there could be opportunities in the shorter term based upon the inefficiencies of VRs and IVRs. So we'll be taking a look at that as we move forward.

Patrizio Vinciarelli | Chief Executive Officer:

So again, we're looking at all of these opportunities in the framework reference of capacity limitations. over the next 12 months. It's not that we can engage with any hyperscaler OEM that has got a need. Virtually all of them do because, as you know, while there's been a lot going on with respect to 800-volt bus and converting that to six volts or 12 volts or back to six volts on the way to 1.8 volt, The real issue with respect to enabling AI doesn't have to do with what happens in effect some distance away on an undervolt bus or even intermediate bus. The real constraints have to do with the point of load and they have to do as we've been articulating because of the fact that IBA, intermediate bus architecture, which is how the competitive industry has been doing it, has gathered a near tension between efficient power distribution and an efficient duty cycle and the requisite current density and current gain at the point of load. As I've been saying for quite some time, I think all the focus about the Elander Vault is really missing the boat with respect to the real challenge. It's not that there isn't a benefit to the Elander Vault, There is a benefit. It's a few percentage points of system efficiency, but an inept point of load power system will keep AI from progressing on its performance trajectory, and that's what we're following.

Quinn Bolton | Analyst, Needham & Company:

Understood.

Patrizio Vinciarelli | Chief Executive Officer:

Thank you, Patrizio. Thank you.

Operator | Conference Operator:

And our next question is going to come from Justin Clare with Roth Capital Partners. Your line's open.

Justin Clare | Analyst, Roth Capital Partners:

Hey, good morning. Thanks for taking our question here. First wanted to start off. So backlog increased to 406 million this quarter. And was just wondering if you could discuss the visibility that you have now into kind of fully utilizing FAB1 When you expect to reach that milestone, so just looking beyond the backlog, what visibility do you have into additional customer orders or commitments from customers that would support that full utilization?

Patrizio Vinciarelli | Chief Executive Officer:

So as of yesterday, the backlog is actually closer to 400 million, but beyond that, we see Robust demand. Phil and I were on a call yesterday with a major customer seeing demand doubling every year for the next several years. And they have a lot of visibility with respect to the request for their systems. So the challenge in the short term is to bring up additional capacity, do so ahead of demand. Sorry, I have a cold. Taking care of

customers. We have many customers, most customers, they're single source with us. We have, obviously, a particular responsibility with respect to ensuring that we're not going to be, you know, gating their growth. A lot of it is directly AI-related. but some of it is indirectly related in that the high growth path is fueling, as you know, a growth path for all of the portions of the industry that play one support role or another.

Justin Clare | Analyst, Roth Capital Partners:

Got it, okay. and then just shifting to the capacity announcements here that you made for Fab 2 and Fab 3. I was wondering if you could just clarify, you indicated that those additional sites could increase capacity nearly five times. Is that 5X figure related to kind of physical manufacturing space, production output or revenue generating capacity? And just wondering if you could potentially share What the revenue potential might be as you move from Fab 1 to Fab 2 and Fab 3, assuming full utilization of those facilities?

Patrizio Vinciarelli | Chief Executive Officer:

So around Fab 1, we are space constrained. In other words, we have relatively small parts of land. So we made sure we bought Fab 2 and Fab 3 to avoid getting limited by, in effect, Elborum within that particular site. Both sites have significant upside that could support even more than a 5X expansion. And again, the methodology for expanding capacity, as you might recall, we looked first at just industrial parcels, then looked at buildings in order to reduce the time to accessing a new facility. We ended up doing one of each within a triangle. It's about 30 miles off to the west and to the north of Fab One, relatively short distance, but with a significant level of independency with respect to power fees and All that would be a consideration regarding redundancy with respect to this increments of capacity. The 5X is a conservative number. It could be more than that because, again, unlike Fab 1, we're not going to be limited by elbow room within either one of these sites. Got it, okay.

Justin Clare | Analyst, Roth Capital Partners:

And then just one more, wondering if you could share what you expect in terms of the capital investment for Fab 2 and Fab 3 and what the anticipated timing of that investment would be?

Patrizio Vinciarelli | Chief Executive Officer:

So we are not prepared to share any details today. We're in the planning phase with respect to Fab 2. I think possibly as of our next conference call, We will share some quantitative data with respect to capital investment, but it's safe to say that we're going to be able to fund FAP2 and in due course FAP3 without need for raising any capital. We're adding Thank you. And the next question is going to come from Richard Shannon with Craig Hallam Capital Group. Your line's open.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Well, hi, guys. Thanks for letting me ask a couple of questions as well. Jim, I'd love to put the numbers you mentioned in your prepared remarks here to get to a fourth quarter revenue number. You mentioned a royalty number. I think you mentioned advanced products growth or total product growth. I'm not sure which one. That was coming up with revenues kind of in the $180 to $85 million range for the fourth quarter. Am I doing the math right? Or if not, can you correct me?

Jim Schmidt | Chief Financial Officer:

I'm going to give you a specific question, but I do want to make clear, Richard, that the number I quoted for 10% product revenue growth is total product revenue growth. Okay? And what I said about advanced product revenue growth within advanced products will be yet again another double-digit increase in that category of product.

Patrizio Vinciarelli | Chief Executive Officer:

Well, let me give you more color with respect to this. So, as we discussed earlier... The licensing side of the business has got lampiness, potential for additional deals. We're taking the long-term horizon. We're not in a hurry to get any deal done. As time goes on, the cost to hyperscalers and OEMs for VPD license goes up at a pretty fast clip as we progress through the investigation at the ATC. But there could be deals done. This quarter, and for that reason, we really can't give you a guidance that we would be comfortable with, given the level of uncertainty. And for that reason, what we provided with in terms of helping you set expectations is, with respect to the pro side, that which we can predictably expect to deliver, which is a low double-digit increase in product revenue, hardware revenue, separate and apart from licensing income, for which we provided a minimum of $43 million, and that assumes no new deals are done within Q4.

Jim Schmidt | Chief Financial Officer:

Richard, one other point to mention. The $43 million, as we've said, and Patrizio just said, doesn't rely on any new deals, but inherent in the licensing agreement we have, there's potential for incremental royalty revenue just as a function of the existing arrangement. We can't predict that exactly.

Patrizio Vinciarelli | Chief Executive Officer:

That's right. So it could be that the number that we are forecasting, the minimum of $43 million, and Zapalachian that even without New Deal. So it's very conservative now.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

It's a baseline and that's what investors like to see. So I just want to verify that. Thank you for that. My second question is related to licensing kind of the notion of run rate here. You mentioned kind of a $43 million run rate, again, assuming nothing else gets done. And let's start with that notion in mind here. So you've mentioned that most of the licenses you've done here in the past have been two-year terms here, and I think the first one is coming up for renewal or will be expired in the not-too-distant future. And so I wanted to get a sense of your expectation of renewals of those so that we can assume a real recurring run, right, that's going to go for many quarters in a row. So if you could comment on that, that'd be great, please.

Patrizio Vinciarelli | Chief Executive Officer:

I think it's becoming more and more apparent that Vigor's pioneering role with respect to a density power system is multifaceted. As recently as a year ago, even within a shorter time frame, all the focus was on NBMs as part of IBA, so a stepping stone to the point of load for competitive alternatives. Again, we don't use NBMs because the factorized power system doesn't require intermediate pass converter, but virtually all of the competitive alternatives do. The focus clearly has recently shifted to VPD, which is... on a different scale of significance, right? It's significance in terms of enabling AI power systems is much greater than NBMs because it's not the intermediate bus converter, but it's the point of load system, which is where the spotlight,

where the focus should be. And So there is greater value associated with that and we're capturing that value. We captured that value with the first VPD license. We'll be capturing that value with additional VPD licenses or inclusive licenses that involve the combination of MBMs, VPD and other VIGOR technology that over time is also to become an issue for unscrupulous competitors to contend with.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Okay, great. Thanks for that detail. I'll step out of line. Thank you.

Operator | Conference Operator:

Thank you. And the next question will come from John Dillon with DMV Capital. Your line is open.

John Dillon | Analyst, DMV Capital:

Hi, guys. Congratulations to the whole Vicor team. Incredible quarter. Phil, my question is really for you. It's... With the exception of Vicor, I've never heard of any company claiming that power supplies could enable higher performance processors. Yet Cerebus just announced a new CS4 AI processor, and Angela Young, the Senior VP of Products, stated that the wafer scale engine stayed the same as the CS3. So the CS3 had the same memory and logic, but it had 2x the increase in speed, and with three of these together, they had 10x the throughput of three wafers. and she contributed a big part of the increase was their ability to deliver higher density power to the same wafer. So Phil, I find this extraordinary. Can you walk us through that and let us know what the reactions are from your new target customers now that you're demonstrating the benefits of the second gen VPD?

Patrizio Vinciarelli | Chief Executive Officer:

So John, we're not going to make any comments that are specific to any customer, right? I'm going to answer your question in general terms. with specificity. Every generation of AI processor is stepping up its current requirements by a dramatic percentage increase. What used to be very iconic requirements not that long ago of a few hundred amps, right? Following the era of Intel processors that were barely consuming hundred amps. It's now at the thousand amp level and on its way to thousands of amps. And then there are leading edge applications such as welfare scale engines where you're dealing with tens of thousands of amperes going to 100,000 amperes. That's where the action is. That's where, you know, inference and other enabling capabilities get realized. And the fundamental fuel by current, the fuel by current at every decreasing voltages, which makes factorized power, we call multiplication, the technology of choice, and conversely, fundamentally handicaps, the competitive approach where the upper voltage is in effect averaged down by mixing a low voltage source, i.e. one that is inefficient in terms of its power distribution with ground, which is fundamentally zero volts. That kind of technology is a nearly handicap with respect to keeping up with AI demands. And conversely, our technology was envisioned a long time ago, and we kept on improving it, right? We got lots of new developments related to factorized power, SAPs, components. And these are reflected in the level of performance that we're bringing out with every new generation, right? The initial demonstrations, vehicles for second-gen VPD reached three amps per square millimeter. We are not that far away from five, six amps per square millimeter capability. We're going from what used to be, you know, in a timeframe where we're powering a GPU many, many years ago with current multipliers to the level of three and a half millimeters. We're now one and a half millimeter. In six months, we're going to be up one millimeter. So it's this kind of technology, the packaging technology, power conversion engines, control systems, unique components that enables AI.

Phil Davies | Corporate Vice President, Global Sales and Marketing:

So John, just to build on that, I think Just to build on what Patrizio said, I think that was on display last week at Open Compute with our meetings with several big customers in terms of their level of excitement around our second generation VPD. They've been waiting a while to see it. We've been focused on our lead customer. But now we're here. We've got the demo system set up. They were excited by what we showed them. So I think it's now up to us to roll this forward and to bring these deals home within our capacity constraints, our near-term capacity constraints.

John Dillon | Analyst, DMV Capital:

Okay, now, before you've talked about pricing per watt, to a twice the power with the 5th Gen solutions, are average selling prices going up?

Patrizio Vinciarelli | Chief Executive Officer:

Let's not get into that. I think what we can say is that Our total competitive standing, which obviously leads with performance, but needs to deal with cost, is becoming stronger and stronger because we have the right approach to solving these point of load challenges. And with that right approach, inherently, there are scalability and cost advantages that will materialize as we scale up from and the rest of the industry is foolishly going down a dead-end road.

John Dillon | Analyst, DMV Capital:

Excellent. And the IVR customers you mentioned last time, how's that progressing? And that'll be my last question.

Phil Davies | Corporate Vice President, Global Sales and Marketing:

So again, as we talked about, John, IVRs, it's very early days for IVRs in terms of really delivering solutions to customers. They're intrigued by using IVRs on some of the rails. I think for the high current rails, we have the best solution. So It might be all Vicor. It might be some Vicor and some IVRs. We don't know yet. We'll see how that plays out. But IVRs have a way to go yet in terms of proving their performance sort of claims.

Patrizio Vinciarelli | Chief Executive Officer:

So we had several meetings last week on the IVR front with two IVR companies and an hyperscaler interested in solutions, IVR solutions, using one of these two companies. and so we were told by the hyperscalers that when it comes to feeding the IVRs at 1.8 volt, we would be the only solution. I think it remains to be seen, the jury's still out with respect to how soon these IVRs will become a practical reality. The good news is that these hyperscalers saw that We have a solution that doesn't involve IVRs. So fundamentally, they can come to us for either alternative, one that involves IVRs, with that which IVRs provide, which is, you know, to be honest and fair, they provide flexibility, at least now in theory, but in reality, they will, over time, provide flexibility, but that flexibility comes at a significant cost. When everything is sent down and you deal with the real numbers and not the marketing numbers, the insertion cost to, in effect, process power through an IVR stage is close to, it's upwards of 10%, and it could be pretty close to 15%. And for that 10, 15% of extra power dissipation, all that you're getting, all that the customer is getting is a current gain of two and a half. Now it does provide flexibility, but from a power system efficiency perspective, it's a very charged proposition. We're open-minded though. We were perfectly willing, eager to play a support role

with respect to our VR application. And fundamentally the same point of low technology enables us to deliver and thousands of amps at 0.5 volts with the requisite current density, bandwidth and all the right attributes, that same technology can deliver 1.5 volts to an IVR. And if customers, for whatever combinational reasons, want to go down that path, we'll be there to support them.

John Dillon | Analyst, DMV Capital:

Excellent. Thank you very much.

Operator | Conference Operator:

Thank you. And our next question will come from Richard Shannon with Craig Hallam Capital Group. Your line's open.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Well, great. Thanks for letting me ask a follow-on here. In the press release and in the call here today, you've used a couple of terms that I'm unfamiliar with, stage two and stage three licenses. If you can explain those, that'd be a big help here.

Patrizio Vinciarelli | Chief Executive Officer:

Yes, I'd be happy to. Actually, if you go If you go to our website, we now have a licensing page. And on the licensing page, you can get an answer to the question. And it's a quantitative answer to the question as it relates to royalty rates, which change as a function of the stage. So fundamentally, for any VIGOR patent in our portfolio that has not been asserted, A prospective licensee can take a license at stage zero. That's the most cost-effective license. It's most cost-effective because Vigor has an ad to get into deals with law firms to assert their IP and go through, in effect, the enforcement effort. But if... The parents are being infringed, and we have to assert them to a extent that there's a cost to doing that. As time progresses and the enforcement effort advances, we increase the royalty rate in relationship to what we call stage X inflation. So after stage zero comes stage one, two, three. So three begins when the IDC institutes an investigation. And the first roughly 10 months of that timeframe, which is during all the phases of the IDC process before We have increments in the royalty rate, as you can see from the website page, the level of about 5% per month. As we get into the hearing and then the initial determination by the administrative law judge at the ITC, the final determination, in exclusion order and enforcement of the exclusion order by Council on Border Patrol, the cost to a, in effect, a late licensee that, in effect, has taken a wait-and-see attitude or has approached this from the perspective of taking its chances, it keeps escalating because our cost... has gone up. And with that, we deserve to fetch more with respect to the patent and its value. So all of this is intended to encourage early adoption, encourage S&C not to take the chances, not to roll the dice. We got a track record of knowing what we're doing. And we're going to keep doing that. And we're very determined that we're very well equipped with partners that have a vested interest in the right outcome, which is not the case for our opponents. So that's how the various stages of this process relate to time. and the cost of the license, its royalty rate. And if you look at the webpage, there are curves that define this progression. And part of the reason for this is to have a level playing field, right? It's very important that we treat each and every licensee fairly. All of these licenses have got most favorable licensee provisions, which means that You can grant to a following licensee a license on better terms than a prior licensee under similar conditions. Well, similar conditions, among other things, means at what stage the prior licensee took a license as compared to a new licensee. So we have documented our practice, among other things, to ensure that we have a complete Confidence, transparency, and fairness, and consistency in our methodology.

Richard Shannon | Analyst, Craig-Hallum Capital Group:

Patricio, thanks for that detail here, and I see the web page here very comprehensive and complete, so thank you for that. My follow-on question is regarding the AI OEM that you signed the license with in the third quarter. The two-part question, the first one is, why was that license Seemingly mostly a non-recurring or one-time license versus something that might be ongoing. And second of all, can you state which stage this third quarter AI OEM was licensed at?

Patrizio Vinciarelli | Chief Executive Officer:

So we didn't say that that's not recurring to the contract. Maybe the source of potential confusion was my comment to the fact that that which has been characterized now several times as non-recurring, keeps recurring. So the definition is not non-recurring. But beyond that, what we recorded in Q3 from this first pure VPD license is far from non-recurring, whichever way you want to look at that word. In fact, There was at the beginning of Q4 another significant licensed PO that came from the same new licensee. So these licenses are structured, whether they're all inclusive or per unit, to be in effect proportionate to the use of the technology by the licensee. and obviously as time goes on and licensees make greater use, they pay royalties in direct proportion to that. You know, we have different ways of making this happen fundamentally, two approaches, either on a per unit basis or by estimating what the use by the licensee is going to be over a couple of years. and having an all-inclusive license that deals with that timeframe before we take on the next couple of years.

Jim Schmidt | Chief Financial Officer:

Richard, just to amplify what Patrizio said, it's better to think about the royalty revenue as recurring, okay? It's a licensing practice that is now up and running. It's generating royalty revenue. It's proportional to the use of what otherwise would have been infringing technology. so it's very important everybody understand that we've used a couple of quarters of catch-up but really think about this as recurring revenue now it's in the P&L.

Patrizio Vinciarelli | Chief Executive Officer:

It keep on coming at increasing levels so I think it was perfectly appropriate a couple of years ago to look at a landslide contribution in one quarter as non-recurring back then there was obviously the A conservative way to think about it. But now, to Jim's point, obviously there's been a lot of recurrences of non-recurrent things, and they're no longer non-recurrent.

Operator | Conference Operator:

Thank you. And our next question will come from Justin Clare with Roth Capital Partners.

Justin Clare | Analyst, Roth Capital Partners:

Hey, thanks for taking the follow-up here. I just wanted to follow up on the capacity expansion here, particularly for Fab 3. Wondering how we should interpret the land acquisition that you made for Fab 3 at this point. Is that a commitment to add additional capacity, or should we view that more as an option to potentially accommodate longer-term growth? and then just trying to think through how long it might take for you to get to, you know, fully utilizing, you know, 5X the capacity that you have with Fab One.

Patrizio Vinciarelli | Chief Executive Officer:

So we bought LN, we closed a week ago or thereabouts. So, but we're not going to act on it in terms of putting up a building there for now. The logic of... having that flexibility was in effect to make the most out of the process that we went through earlier this year in investigating these various options that carry different trade-offs, right? So on a new campus, we have tall flexibility with respect to the complement of buildings, how they relate to each other, in terms of next FABs. That's very valuable in terms of medium, longer term planning. It is distinct from the need to act in the very short term with respect to expanding capacity within an existing building. So we now have what we do all to take very short term steps with a time scale of five, six months on the one hand within an existing building Thank you very much. having a call with the CEO of a major customer wanting to, in effect, sell capacity over the next few years. These kinds of discussions are going to facilitate decisions with respect to when to pull the trigger on the next incremental capacity.

Jim Schmidt | Chief Financial Officer:

And it might be worth mentioning the call they had was not with an AI customer. Yeah, okay.

Justin Clare | Analyst, Roth Capital Partners:

Okay, interesting. Thanks. And then just one other follow up. You know, you mentioned that you plan to, I think, start adding equipment in Q2 for Fab 2. And so just wondering, do you anticipate running at near full capacity for Fab 1 next year? And that kind of justifies the ramp up of Fab 2 into next year?

Patrizio Vinciarelli | Chief Executive Officer:

Yes. Yeah. So unfortunately, for the near term, we have certain capacity limitations, right? And they are, to be clear, dependent on specific platforms related to particular process steps. You know, they are such that we can grow revenues, as Jim pointed out earlier. We expect low double digits increase in product revenues this quarter. But as we've been explaining over the last several calls, we're getting closer to getting to full capacity utilization of FAB1 and the need to step with some of the process steps into FAB2 starting Q2 of next year.

Justin Clare | Analyst, Roth Capital Partners:

Got it. Okay. Thank you.

Operator | Conference Operator:

Thank you and this is all the time that we do have for questions today. So this will conclude today's conference call and thank you for participating and you may now disconnect.