LightPath Technologies, Inc.

Fiscal 2022 Second Quarter Financial Results Conference Call

Thursday, February 10, 2022, 5:00 PM Eastern

CORPORATE PARTICIPANTS

Sam Rubin - *President, Chief Executive Officer*

Al Miranda - *Chief Financial Officer*

PRESENTATION

Operator
Good afternoon, everyone and welcome to the LightPath Technologies Fiscal 2022 Second Quarter Financial Results Conference Call. Please note this event is being recorded.

At this time, I'd like to turn the conference over to Al Miranda, Chief Financial Officer at LightPath Technologies. Please go ahead.

Al Miranda
Thank you. Good afternoon, everyone. Before we get started, I'd like to remind you that during the course of this conference call, the company will be making a number of forward-looking statements that are based on current expectations, involve various risks and uncertainties, including the impact of COVID-19 pandemic discussed in its periodic SEC filings.

Although the company believes that the assumptions underlying these statements are reasonable, any of them can be proven to be inaccurate, and there could be no assurances that the results would be realized. In addition, references may be made to certain non-generally accepted accounting principles or non-GAAP measures for which you should refer to the appropriate disclaimers and reconciliation in the company's SEC filings and press releases. Following the management's discussion, there will be a formal question and answer session open to participate on the call.

I would now like to turn the conference over to Sam Rubin, LightPath's, President and Chief Executive Officer.

Sam Rubin
Thank you, Al. Good afternoon to everyone, and welcome to LightPath Technologies fiscal 2022 second quarter financial results conference call. Our financial results press release was issued after the market closed today and posted at our corporate website.

The company's performance in the second quarter demonstrated significant progress in the expansion of our product portfolio and business development pipeline, as we have been successfully implementing our new strategic direction. Our new strategic direction, which we began rolling out approximately one year ago is delivering the intended results with the company transforming itself into a leading global partner for optical engineered solutions with a highly differentiated products platform as the foundation for the new LightPath.

At the same time, we are delivering with operational discipline as we invest in new growth opportunities. While the financial recovery of…for our existing operation takes longer than anticipated following the transition of our business in China. This transition pertains to the discovery in our fiscal 2021 fourth quarter of irregularities in our China operation, which after closer look turned out to be illegal activities by the management of our subsidiaries in that country, including the misappropriation of company money and the re-routing of customer orders to third parties, activities which we now know had been going on for a very long time.

We've eradicated the problem areas, replaced the management team, and overhauled our control systems to avoid any recurrence of such events. But at the same time, we were also negatively impacted by a reduction in telecom revenues in China from a large customer who had lost its own contract and stopped issuing any new orders.

Our revenues in totality from China remain below where we thought they would be in terms of recovery, which has had a corresponding impact on our profitability since telecom sales, which principally had been for 5G infrastructure build outs are for products, which produce some of our highest margins. While we are glad to share that the said telecom customer has now began ordering again, those orders are still at a much lower volume than before. And we expect to take a couple of quarters to start scaling.

Beyond these challenges in China, our overall business globally continues to be solid. Revenues for the second quarter and backlog at the end of the period, increased from the first quarter. The backlog factors in the renewal of our largest annual supply agreement. This contract is for the purchase of a variety of infrared optical lens elements by a major commercial customer and demonstrates our ability to supply high quality infrared optics on a commercial scale for an impactful OEM partner.

More important is the future growth potential presented by recent achievements, as we continue to execute against our strategic plan. Prior to the second quarter, management focused on executing on important changes necessary for our future growth and evolution as a company in terms of corporate governance and ESG, organizational leadership and workforce alignment. Another critical phase was infrastructure investments to increase and align capacity and capabilities.

Most recently, during the second quarter, we announced several technological and manufacturing process developments that create a basis for further differentiating the solutions we can offer as a partner to our customers. Such differentiating technologies are key in transitioning the company from a component provider, which produces items at a customer specification to the solution provider, which leverages those differentiating technologies to have a in-depth dialogue and involvement in the customer's design process, and capture some of the value created by owning the IP, which translates to premiums in prices.

LightPath is leveraging its legacy as a low-cost provider with some of the industry's best high volume manufacturing capabilities, to emerge the partner for our customers on designing optical engineered solutions, where we are adding value by offering the best solutions. As we had previously outlined, this moves us from being a component supplier, a reactive player focuses on being the lowest cost provider to a partner that brings the domain expertise in optics to the table, a position that is naturally more proactive and value-added.

This process is part of our strategic plan, which is driving our path forward. And it is now beginning to deliver the intended results with our business development pipeline, [indiscernible] forwards on the strength of our new freeform optics, infrared materials, and other technological innovations, particularly for LiDAR, AR/VR, and space applications.

Since introducing freeform optics in October 2021, we have been engaged in an increasing number of opportunities, which include non-recurring engineering projects, NREs and other programs, which could lead to valuable volume production orders. At present, we have a total of eight such high value, high-volume projects in development, all going through the customer qualification process. This is an increase of five projects from the three that we discussed during our last quarterly report.

Almost all of those programs in the area of LiDAR and AR/VR and have all launched as a result of customers realizing the value of our new freeform technology and are now working closely with us to leverage those capabilities to deliver performance they could not previously achieve in their systems.

Growth in these programs, as a result of customers wanting priority access to freeform technology among our expanding platform of proprietary materials and manufacturing processes. Once in production, each of those opportunities ranges from $1 million to $5 million in annual revenue potential with staggered projection production start date over the next 24 months.

In short, we can go from one 10% customer to many of them, where our operating and financial performance will benefit from leverage on the manufacturing floor and less commoditized solutions to gain pricing power and avoid margin compression. Aided by the substantial completion of investments in manufacturing, coating, and finishing that are integral to our strategic plan, we are excited for what may materialize for growth in revenues and profitability.

We are now in the process of volume production readiness for our expanded coating facilities in Europe with no major investment planned for the remainder of this fiscal year. Our next focus in capital investments will be the expansion of our facility in Orlando in the next fiscal year.

With vertically integrated manufacturing capabilities on three continents, we are increasingly being sought after by customers and industry partners alike, which positions us to broaden our product portfolio and address some of the most prominent growth sectors of the economy, including LiDAR, augmented reality, and space technologies.

Large automotive related customer relationships are being developed for LiDAR and thermal imaging to provide both autonomous driving and enhanced vision capabilities. Today, we are in a much better competitive position to access these large opportunities due to our differentiating technologies, and in particular, our award-winning freeform optics manufacturing technology.

The industry's response to our introduction of freeform optics manufacturing technology with high volume production has been nothing short of overwhelming. Freeform optics can potentially minimize the size of consumer products such as augmented reality glasses and laser projectors. Additionally, the enhancements that freeform optics provide to optical design allow, for example, designing much wider field of use systems or better resolution and sensitivity, for applications such as LiDAR.

However, adoption had been constrained by volume manufacturing inefficiencies. By extending our molding technology into the production of high precision freeform glass optics, we are now enabling mirrored new applications and miniaturization of existing optical systems to a level that optical community has been demanding for a long time.

Two weeks ago, we announced that our new freeform optics technology had won the 2022 Prism Award for Manufacturing. Winners were announced as part of the SPIE Photonics West trade show, one of the industry's most important events of the year. The Prism Award is an annual international competition that honors the best new optics and photonics products and technologies on the market.

As mentioned, we now have underway a number of large NRE projects for the development of new custom freeform optics and sub-systems, projects which represent revenue in the form of development work that is paid for by the customers with resulting intellectual property owned by

LightPath are expected to lead to production orders that require a series of lenses or assemblies, which would substantially increase the company's current manufacturing volumes.

Once in production, through separate contracts, the proprietary nature of such non-commoditized orders suggest that the higher revenue generation associated with the greater volumes also will deliver an improvement in gross margins as compared with the company's existing product lines. As such, we are delivering on the strategic objective of transitioning into a value-added engineered solutions partner for large global customers as they pursue next generation technologies.

While our product portfolio has made great strides and now addresses some very exciting growth markets, our spending on research and development remained under $6,000 for the quarter. This spending has been supplemented by NRE projects, as well as grants and partnerships, which serve as a testament to our leading expertise in photonics. Furthermore, we're very pleased to have recently been funded by the European Space Agency and Space Florida to advance the commercialization of our infrared materials to be used for optics in space.

A key objective of our strategic plan is to move up the value chain in targeted areas based on technology and engineering capabilities that we have today. To this end, we were honored to have been selected for an exclusive optical usage license to manufacture products using the infrared patented portfolio developed and owned by the United States Naval Research Laboratory.

The agreement with NRL provides LightPath with access to an IP portfolio of unique [indiscernible] composition to develop more advanced optical systems, targeting some of the fastest growing biomaterial market, including the infrared imaging market, which is expected to grow from $5.8 billion in 2022 to $8.3 billion by 2025, and the multispectral imaging market, which is estimated to grow from $10.9 billion in 2022 to $17.6 billion in 2025. I'm pleased to report that we are receiving very strong market feedback on our NRL IP portfolio, which reaffirms our assumptions that such materials provide significant value.

Another development that supports our better positioning is in the area of pricing. In recent months, like the rest of the world, we have experienced price increases on raw materials and energy. As Al will mention in his comments this has also impacted our margins, in particular, in infrared optics, which are mostly manufactured in Europe where energy prices increased as much as three times higher rates. We are pleased to share that our stronger positioning allowed us to work closely with our customers, where we have been able to, for the most part, increase our prices to offset such increases in costs.

Those price increases will start showing an impact in the middle of Q3, and we believe will offset what would otherwise have been eroding margins, something LightPath had experienced all too often in the past. While building for the future, we are not without discipline in the present. Looking at key performance measures, we ended the fiscal 2022 second quarter by increasing our cash balance and reducing total debt and inventories as compared to the end of first quarter.

Inventories are now at a four-year low. So, we are demonstrating operational efficiencies as our backlog and revenues remain near historically high levels. Backlog grew to $21.9 million at the end of the second quarter, an increase of over 13% from the end of the first quarter, following a new renewal of a large annual infrared optics supply agreement valued at $4.2 million.

Capital investments were modest at about $118,000 for the second quarter, which is within our budget for the year as we had completed a significant increase in manufacturing capacity expansion last year in accordance with our strategic plan.

The impact of our technology development efforts, our partnership and our overall product and manufacturing expansion is a migration to higher end engineered solutions that support us with an exposure to large customers and accelerating growth markets, which are expected to lead to increased profitability particularly since it is unlikely, we would face the same commodization and competitive issues of some of our more mature product lines.

Reflecting this continued progress and outlook for growth, LightPath's leadership made open market purchases of Class A common stock during the first…of the first fiscal and second quarter. I was among this group in the first half of the fiscal year, and now stand even more aligned with all our shareholders.

This concludes my formal remarks. Now, I'll pass the call over to Al Miranda, our CFO, to review financial results for the second quarter.

Al Miranda
Thank you, Sam. I'd like to remind everyone that much of the information we're discussing during this call is also included in our press release issued earlier today and will be included in the 10-Q for the period. I encourage you to visit our website at lightpath.com to access these documents.

Since Sam just covered the highlights of our strategy and our key accomplishments and business drivers, I will discuss some of the primary financial performance metrics and provide additional color on them to better assist investors in analyzing the company.

As a reminder, we had been significantly impacted by the transition and business conditions in China during the fourth quarter of fiscal 2021 and to a lesser extent in the first and second quarters of the current fiscal year. At this juncture, while revenues have been recovering; they still remain below the pre-transition level. LightPath's second quarter financial results are also negatively impacted by expenses associated with the management and employee transition in our Chinese subsidiaries.

On an expense basis, one-time cost charges and accruals were incurred in large part during Q4 of fiscal year 2021 with additional items in Q1 and Q2 of this year, all of these items are fully addressed in our earnings press releases and SEC filings. While certain civil legal proceedings were ongoing, we are unaware of any further expenses or charges to be incurred going forward. At the same time, we remain focused on our overall strategic plan, and we are on a trajectory for longer term growth and profitability.

On a consolidated basis, revenue for the second quarter of fiscal 2022 was over $9.2 million. That's up from the first and fourth quarters. So, we are seeing sales building back, but we are down from prior year period of $9.9 million.

Sales of infrared products comprise 55% of the company's consolidated revenue in the second quarter of fiscal 2022, as compared to 48% of consolidated revenue in the same period of the prior fiscal year.

Visible precision molded optics or PMO sales represented 41% of the consolidated revenues in the second quarter of fiscal 2022, as compared to 48% in the same period of the prior fiscal year. PMO sales as a percent of overall sales is lower than optimal, Sam has said, due to reduced sales to our major telecom customer in Asia. Specialty products continue to be a small component of the company's business, representing 4% of consolidated revenues in the second quarter of fiscal 2022 and 2021.

Revenue generated by IR products was approximately $5.1 million in the second quarter of fiscal 2022, an increase of 4% sequentially from $4.9 million in Q1 of 2022 and up 6% and $4.8 million in 2Q 2021. The increase in revenue is driven primarily by customers in the industrial and defense markets.

PMO sales were $3.8 million in Q2, flat from Q1 and down 21% from $4.7 million in Q2 of fiscal year 2021. Year-over-year decline is due to lower telecom sector revenues and other sales in China, as mentioned. Beyond these reductions, the company's PMO revenues have strengthened in the areas of sales, through catalog and distribution channels, as well as increases in sales to customers in the industrial, commercial, and medical industries.

Specialty revenue is sort of a catchall for products or services that don't fit the other two categories. And they represent a small component of our consolidated revenues. Over the last few quarters, there has been a shift from one-off products towards more NRE projects. This is a different type of revenue altogether.

As discussed last quarter, we expect to see an increase in NRE revenues this fiscal year driven by the need to engineer solutions for new products like freeform molded lenses as Sam has mentioned.

These are one of our new key technologies that we're bringing to market. As we develop these types of products and deliver prototypes, and they are accepted and qualified, we would then expect to receive production orders where we manufacture in quantity. In Q2 2022, we handled a growing number of NRE projects for commercial and defense application again, as Sam mentioned earlier.

Let's now move the discussion to margins. I'd first like to share some background that will be helpful for modeling purposes and in understanding the impact of our overall strategic direction. PMO margins are typically higher due to our molding, which enables mass production and a more automated machining process.

IR historically was more manually produced. But with the growth in our molding technology, as applied to IR products being made from our proprietary BD6 material, the margins will increase from both the advantages of the material cost and using the automated molding process.

In addition, as we migrate towards engineered solutions, we expect margins to increase. This is due to several factors, including multiple lenses required for an assembly, both types of lenses used in a single solution and custom-built solutions, where our engineering and proprietary designs along with our manufacturing and assembly will dictate pricing and margins that may be more immune to industry trends.

As a result, ASP, average selling price, which is often cited by analysts who cover us may be rendered less relevant in the future. To this end and for competitive reasons, we are going to speak to other metrics and not ASPs when addressing revenues, costing and margins.

Our consolidated gross margin as a percentage of revenue was 30% for the second quarter of fiscal 2022, compared to 37% in the same period of the prior fiscal, and 35% in the first quarter of fiscal 2022. The decrease in gross margins as a percentage of revenue is primarily due the mix of products sold in each respective period.

While IR sales have increased, the majority was on a high-volume contract. We also had a negative impact on margins as we extended our coding capabilities in Europe. The ramp up and learning curve of coding in the quarter means fully burdened costs with low volume output. And this is typical for a new coding implementation.

Moving on to operating expenses. During the second quarter of fiscal 2022, total operating expenses were $3.8 million, an increase of $206,000 or 6% as compared to $3.6 million in the same period of the prior fiscal year. SG&A costs increased by approximately 7% as compared to the same period of the prior fiscal year. Higher SG&A cost is primarily due to $153,000 of expenses incurred in Q2 associated with our transition in China, including legal and consulting fees.

In addition, we determined that one of the Chinese subsidiaries is obligated to pay $248,000 in VAT [ph] and related taxes from prior years, which was accrued during the three months ended December 31. The remaining increase in SG&A expenses is due to increase in personnel related costs and a moderate increase in travel expenses as COVID-19 restrictions are reduced. These increases were partially offset by the absence of approximately $400,000 of non-recurring additional compensation to the company's former CEO in the prior year period.

In terms of total employees globally, we now have 15% fewer than we did a year ago. We hired senior executives to help with our strategic implementation, that including scaling of operations, as we prepare for significant growth ahead. In addition, we replaced our temporary leadership in China with permanent hires that are more well versed in the industry, as opposed to the fixers or crisis management experts we initially brought on. Several key roles throughout the global organization were filled by promoting from within, which is something we would like to emphasize.

This approach also helped us realign our product groups in the direction of our new strategic plan. To this end, we created technical engineering, sales leadership for select product groups, and we expect to add one more for this purpose, otherwise we are at an optimal workforce level at the present time.

Moving on, net loss for the second quarter of fiscal 2022 was $1.1 million or $0.04 per share compared to a net loss of $147,000 or $0.01 per share in the second quarter of fiscal 2021. The increase in net loss for the second quarter of fiscal 2022 was primarily attributable to lower revenues, and gross margin and increased SG&A expenses including the one-time expenses.

The resulting decrease in operating income was partially offset by a decrease in the provision for income taxes of approximately $206,000 as compared to the same period of the prior fiscal year. For modeling purposes, we have remaining NOLs to cover our profits on a consolidated basis in the US and pay only Chinese income tax. In Latvia, they level a distribution tax on distributed earnings, but we reallocated the profits to future growth activities. So, we have not been accruing tax on earnings there.

Cash was $5.1 million at the end of Q2, 2022, up from $4 million at the end of Q1. Cash flow provided by operations was $1.4 million in Q2 compared with the net cash used in operations of $157,000 for the first half of the year. This compares with cash provided by operations of $880,000 in Q2, 2021 and $1.5 million for the first half of last year.

Second quarter differential cash flow from operations is primarily due to changes in working capital items, partially offset by the net loss. Cash invested was $118,000 for Q2, and over $1.3 million for the first half of this year. Cash used in financing activities was $192,000 for Q2, and the effects of exchange rates on cash was a negative $4,000. Therefore, the change in cash was positive $1.1 million for Q2 and negative $1.7 million from the end of the prior fiscal year to the end of the second quarter of fiscal 2022.

At December 31, 2021, from the beginning of the fiscal year, receivables increased by $300,000, payables and accruals reduced by $653,000 and inventory has declined by $1.4 million to $7.3 million in total.

Our backlog as of December 31, 2021, was $21.9 million, up from $19.3 million at September 30, 2021, and $21.3 million at the start of the fiscal year. The quarter ended backlog is the highest level in a year, which accounts for new contracts signed and the renewal of our single largest contract valued at $4.2 million, which have been partially offset by the reduction of certain telecom business as we've discussed.

For our largest contractor are normal deliveries through the year, to bring the backlog level down as the year progresses. This December's renewal of our largest contract marks the fifth consecutive year that we have won the high-volume order. In addition, from the same customer, we have expanded our relationship as a value partner to provide other IR solutions under separate programs. As a reminder, it is customary for our backlog to fluctuate during the year because of the timing of bookings of orders and annual renewals from all of our customers.

With this review of our financial highlights and recent developments concluded, I'll now turn the call over to the operator, so we may begin the question-and-answer session.

QUESTION AND ANSWER

Operator
Ladies and gentlemen, at this time, we will begin the question-and-answer session. To ask a question, you may press "*" then "1." If you are using a speakerphone, we do ask that you please pick up your handset before pressing the keys. To withdraw your question, you may press "*" then "2." Once again, that is "*" then "1" to ask a question. We will pause momentarily to assemble the roster.

The first question today comes from Brian Kinstlinger with Alliance Global Partners. Please go ahead with your question.

Brian Kinstlinger
Great. Thanks so much. First, really easy one on the numbers. Your year-over-year trends have been [technical difficulty] by your large China telecom customer. Can you tell us what your year-over-year revenue growth would be without this customer during 2Q? So, if you took it out of a year ago's quarter and this quarter, what would the comparison year-over-year be for revenue?

Sam Rubin
We'll pull up the number while we are speaking, if you have a follow-up question maybe we start with that one.

Brian Kinstlinger
Yes. No worries. Yes, that's fine. So, I wanted to talk about the eight…the group of content engineering programs, it's helpful to get those details you gave, before they go to production, I suspect you're going to find out whether they're going to move forward with your lenses as part of production. So, what point…at what point do you expect an indication? Is that in calendar 2022 from any of these or a few of these, or is that too soon?

And the second part of that question is of these eight programs, are they also testing other optical providers lenses, or right now, are they exclusively testing yours?

Sam Rubin
Yes. A great question. I think as you indicated, the process between the moment we developed the initial items until we're actually in production is fairly long. In most cases, it's a very structured process, such as EVT, DVT, and steps like that and production readiness, especially in the automotive. I'd also…and so the time we're talking about delivering initial prototypes for almost all of those eight in the next three or four months, I believe. But from the initial prototypes, they need to go through extensive testing and in some cases, environmental testing. Then we need to do the transition into manufacturing, the DVT and low volume and so on. And that can take as much as a year until production actually scales to the long-term projection numbers we have from customers.

At the same time, I mentioned it last quarter, and I want to emphasize it again, many of those customers have not established product lines, as we're stepping in. So, especially in LiDAR and in some of the AR and VR, successor is not only our ability to develop a product and our product meeting the needs, but it is also the customer winning whatever they need to win downstream and down the globe. And there's, obviously some uncertainty around that.

In terms of competing with others, yes, so actually cases, at least a couple of the eight were the customers are being already serviced by another vendor out in Asia, and they're coming to us because that vendor specifically cannot achieve the same optical performance that we can. So, we still…we feel we even though there are companies working on the freeform and others wanting to go in there, we're definitely, we're confident that we have a significant advantage in that area.

Brian Kinstlinger
The others, you're the only one, you stand on the one hand for your [multiple speakers].

Sam Rubin
Statement, as strong as that. I would say that, yes, all in plastic, in polymer optics there is definitely possibilities that don't existed for a while, and some customers use them, and in some applications it's very suitable. In low volumes and other capabilities, also some have used. As far as I know, there is at least one molding company that I know of that is attempting to produce some freeform molded glass lenses, but so far, as far as I know, unsuccessfully.

Al Miranda
Brian, the answer to your question is Q2 sales would have been up 8% comparatively,

Brian Kinstlinger
Right. That's helpful. That's a better picture of demand outside of one customer. And then on that large Chinese customer, you said there were some small orders, but with that telecom provider no longer having that large 5G infrastructure build-out contract, at least that's what I believe, do you think going forward, we should still expect that customer to remain rather small or is there an opportunity to ramp up at some point for any reason that we might not be aware of?

Sam Rubin
Well, without touching on information the customer might consider sensitive, I would say it's that from what we understand, at least for the next two or three quarters, what we're seeing now is what we should expect. But I don't know what else they have in the pipeline. I do know that from the work they have, they have actually given us a bigger share this year percentagewise compared to what they had in past years.

Brian Kinstlinger
Okay. And then I wanted to touch on the gross margin. If I look at the…and you guys gave some detail, but if you look at the mix of your PMO infrared as a percentage of sales, they were about the same in December and September quarter. So, each of the last two quarters yet, despite the yield issues being better in the December quarter, at least I assume, because you've talked about that last quarter being fixed, the gross margin dropped 450 basis points sequentially. So, what am I missing from this major drop is I thought we'd be recovering all year. Thank you.

Al Miranda
So, Brian, we would definitely have to get into the leads on sort of giving you the, maybe the full-fledged answer you want. But in general, what we saw in this quarter was that the IR margins were lower in Q2 than in Q1. And there were some cost drivers behind that in particular, some of the things that Sam mentioned, which is, this unexpected energy price hike in mid-November and December, the fact that we instituted…we put in place the coding facility in Latvia, fully burdened costs went in in the quarter, but they were still producing at low volume.

So, there's a few factors that went in there, that were cost drivers that were a little bit different than what we saw in Q1. We also have energy cost increases in China, but not nearly as bad as what we're seeing in Europe. As Sam said is correct…we've taken series of corrective actions, which we'll see in Q3.

Brian Kinstlinger
Okay. So, help us because it's my last question on gross margin. And my last question for now. I think gross margin has fluctuated so much and clearly mix drive that…you can handle, and you can't predict mixed just like me, who can is my point. But how should we think about margin going forward? What is reasonable for this business that we should expect going forward, maybe could 50:50 or is that too unpredictable based on size in freeform? I just, I guess it's been difficult to predict and it's, and I've at least been very bad at, so maybe help us out to understand how we should think about that going forward.

Al Miranda
So, I think Brian, for us, what we saw in Q2 is on the low end of what we should…what our expectations are, what internally we model.

Brian Kinstlinger
Right. What is your goal long term?

Al Miranda
Our long-term goal is to get to 40% and hold it there.

Brian Kinstlinger
And it cannot be in 18 months. Could that be sooner, with you bringing on freeform that will hurt yields? I mean.

Al Miranda
I think a lot of it has to do with the ramp-up of freeform and the sort of unique applications and the proprietary nature of the customer relationship that would change the margins for us, and Sam is…

Brian Kinstlinger
Yes. Sam is…

Al Miranda
There's a lot of variables that go into that, the customer, the LiDAR, and those markets, right. When does that…when do those markets take off? And which one of those eight that we're doing business with now are the winners, which ones are the losers? What was the timing of that? Those are things that if you, as an analyst knew you would direct the rest of us, where to invest all our monies.

Brian Kinstlinger
Yes. Okay. Thanks so much.

Sam Rubin
Thank you, Brian.

Operator
Our next question will come from Dave King with B. Riley FBR. Please go ahead with your question.

Dave King
Thank you. Good afternoon. My first question is regarding NRE revenue. What is it now? And what do you think that will be one year from now?

Al Miranda
So, we're not giving that information out just yet. We're not parsing that specialty group to what is NRE and what isn't. And the reason why it's because there's not a direct correlation between a dollar of NRE that doesn't directly correlate into a dollar of new revenue down the road. I think what Sam did is he says we had three projects, we moved it to eight. So, if you think about NRE that way, that's probably a better indicator. If we had three projects, the probability of getting one is 30%, but if you've got eight projects, the probability of getting two is greater than, the probability of getting six. So, I think for the time being, that's a better indicator of the direction where NRE is going.

Sam Rubin
Yes, well, I don't think we look at NRE as a major revenue stream or something sort of usually worth talking about. I brought it up in such an extent this time, because the share of increase and how much interest we're getting, and the money customers are willing to put into sometimes accelerate the development or be earlier in line is I think a very good indicator to just how relevant the technology that we've been developing is. And I think it's in relative terms, we're seeing far more NRE today than I think we've seen in as far as I know, a few years, but by itself, again, it's not a financial measure, that's not.

Dave King
Got it. And regarding those eight projects you mentioned, I assume they include AR, LiDAR. And you mentioned that once they go into production, they could be anywhere from $1 million to like $5 million. Is LiDAR or AR bigger than LiDAR and you know like or so, should we be thinking about AR closer to $5 million and LiDAR closer to $1 million or vice versa, any more color on that?

Sam Rubin
Well, more vice versa. We're seeing the LiDAR tends to be higher in terms of total dollar amount. First of all, more optical components in it, so it's usually everything that we're doing in LiDAR is just set of optics that works together. I guess the car is less sensitive to weight than the person loads. And in the AR/VR, at least now the volumes that we're seeing from customers are modest. And by modest, I mean, it's still tens of thousands of units, but it's not 500,000 units. So…

Dave King
Got it. And then my next question is once all these projects, programs, ramp in the next couple of years, I mean, can you talk about the capacity situation? How are you…how much incremental capacity you need to add?

Sam Rubin
Absolutely. That's actually a great question that we're looking into as we're speaking these days. And the reason is, as I mentioned before, we are very lucky to be able to leverage the fact that we build our own molding equipment in such a way that all of these new free forms and larger lenses and unique lenses we're making, we can make them in our molding equipment. However, the cycle time in them, and sometimes the cost of tooling is going to be different. And we're only now starting to get our feet wet enough with some low volume production of some of those to know what it is. But definitely one way to look at how much units are coming out of a specific molding machine, it would probably be lower, but how much dollar revenue is coming out, it would definitely be higher for those.

Al Miranda
But I think the important part is we can retrofit existing equipment. We don't have to build a whole new factory or buy all new capital equipment. We simply retrofit the existing.

Sam Rubin
At a actually fairly low cost. It's not very significant.

Operator
Our next question comes from Scott Buck with H.C. Wainwright. Please go ahead with your question.

Scott Buck
Hi, good afternoon, guys. I want to circle back on the gross margin conversation. First, what was the headwind on gross margins from the completion of the coding department in Latvia? I mean is that a 100 basis points, or is it something less than that?

Al Miranda
Oh, sorry, Scott. I didn't convert it into a basis point in my head. Yes, I think it's probably one, right?

Sam Rubin
Yes, two, yes,

Al Miranda
Yes. One, one, a little more than one. Yes. It's…no, it's not…like I said, it's common, to have the ramp-up phase and start moving production work in there. So, I'm not concerned about it. I mean, other than it, it negatively impacts our financials, but I'm not concerned going forward.

Scott Buck
Right. No, that's helpful. And then given that, it seems like product mix is going to be kind of what it is for the foreseeable future, or at least the next few quarters. Is there anything proactive you guys can do to help give those gross margins a bump?

Sam Rubin
Yes, so that's a great point because I wouldn't quite say it's necessarily going to be what it is. It always tends to be that infrared products and what we call the diamond turned and such have longer lead times. And so, the time to turn from an order until a shipment is much longer wherein molded optics because of the very large bank or selection of lenses and molds that we already have, we can actually turn around very quickly. And sometimes in a matter of a week or two, from the moment an order comes in, we can ship PMO lenses. So, we are very cautious, because the recovery in China is taking longer and the sales in China are of all PMO, 100%. We don't have anything other than the molded IR and molded PMO in China, but they could…it could turn at any…I don't want to say any day, because that sounds a bit extreme, but it can definitely…that's a ship that can turn around much faster than IR revenue can.

Scott Buck
Okay. That that's very helpful, Sam. And then I'm curious…

Sam Rubin
I'd just say on that, just to finish, we're frustrated from the recoveries there, but wait…and signs are not great that it will accelerate very quickly, but we're keeping hopeful about it.

Scott Buck
Right. No, that's fair. I appreciate that color. And then last from me, I was hoping you guys could kind of touch on M&A. I know it was a little more prominent in the last couple quarters calls, but what are you thinking there. Are you still seeing a fair number of potential opportunities or has that kind of moved to the backburner as you work on some of these organic…these projects.

Sam Rubin
Well, it's…yes, it's a bit of both because some of those opportunities and such need developments and nurturing over time. And so, we continue with that and nothing drastic has

changed in our thoughts about this, meaning we still see it as a part of growing the engineered solution, more significantly. We're still in touch with those companies. At the same time, we extend great discipline internally about where to focus. And so, as we mentioned, we were focusing on operational improvement. I think the results on inventory and cash are great from that point of view, but we're also seeing slower recovery. So, we're also trying evaluating where we are. We wouldn't do something in haste just to get going with M&A or so on if we don't think it's the right time for the company.

Operator
Our next question will come from Orin Hirschman with AIGH Investment Partners. Please go ahead with your question.

Orin Hirschman
Hi, how are you?

Sam Rubin
Good.

Orin Hirschman
In terms of the eight NRE projects, when do you think you have a first, even if it's low volume, the first commercial volume order for the freeform optics? Do you have to get the [technical difficulty].

Sam Rubin
Absolutely, absolutely. We have already one that is, we've shipped prototypes for, and it is going to be a lower volume one for sure. It's not the consumer products and therefore the volume was…that actually to one of the companies that had financed the development of the freeform optics to begin this. So, a long time partner sort of has been waiting for this to mature in order to get what they've been financing.

The second one is a shipment of items for a AR/VR related application, but we're cautious there about volumes because we don't have enough visibility into the customer's pipeline and where those are going. So, I'd say within the next few weeks, we're definitely going to ship at least two…the two customers a good amount of prototypes, but we don't know yet the volume of the freeform optics.

Orin Hirschman
But is it clear that the projects are going into commercial shipment?

Sam Rubin
Yes.

Orin Hirschman
Yes. Again, it is just…I didn't hear the first one, I's a consumer item or not a consumer item. The first one.

Sam Rubin
In optics, the first one is not consumer item, but it's an actually extremely complex product that I think that delivering on that one is probably a much better and bigger indication of the matureness of the technology than some of the more consumer products.

Orin Hirschman
Okay. But you're saying that's also low dollar ones because it's not a lot of actual dollar product?

Sam Rubin
Yes. I mean, that is one…this would be on the lower end of those opportunities.

Orin Hirschman
Okay. In terms of the recovery in China, one of the metrics we look at just to see what's going on in the industrial in general in China is the I believe two laser or three main laser makers here in the United States that compete head on of a handful of Chinese copycats that have come up over the years. So, I guess the question is you ship into all of them, both the domestic ones selling to China, as well as the Chinese. Is that area still growing? When you say recovery in China, do you mean just telecom part? So, with ex-telecom, how is China doing? What's going on in China?

Sam Rubin
Yes. So, when I talk about the recovery in China, I talk more about specific to us rather than macro-economical events in China. And that is when we did the transition and we had to let go of the management that was doing the illegal activities, it actually included our entire sales team in China and with them, a lot of contacts and connections to customers. And so, the recovery from our point of view, besides the financial impact of all of that in terms of expenses and costs and rebuilding team, the recovery is rebuilding the sales pipeline. And it's going well, but it's…we were probably a bit too optimistic at how quickly that would…

Orin Hirschman
Did you lose any major customers in the transition?

Sam Rubin
We're selling less in China than we were selling before. So, I think the answer is, yes, in a way, but as was pointed in the first question of today, excluding the large telecom, we're actually at the growth of 8% year-over-year, really that…hello?

Orin Hirschman
On that note is that the type of growth rate that you're hoping for without a telecom acceleration for the year, 18% or 10%?

Sam Rubin
Well, I don't know for the year. I don't want to make any forward-looking statements or give any guidance on that. But I would say that repeatedly, I have said since I joined LightPath, that the double-digit growth is what we should aspire to. And I still believe in that.

Operator
Ladies and gentlemen, that's all the time we have for the Q&A segment. I will now pass the call back to management for closing remarks.

CONCLUSION

Sam Rubin
Thank you for participating in today's conference call. We look forward to speaking with you again in the near future. In the meantime, we encourage any investor interested to contact

management with any questions and welcome those visiting Orlando during the winter to schedule a tour or meeting at our headquarters, which can be arranged to accommodate health and safety concerns, concerns while being productive and highly informative. We hope you can join us. Thank you again and goodbye.

Operator
Ladies and gentlemen, that concludes today's conference. We thank you for attending. You may disconnect your lines.