

LightPath Technologies, Inc

Fiscal 2022 Third Quarter Financial Results
Conference Call

Thursday, May 12, 2022, 5:00 PM Eastern

CORPORATE PARTICIPANTS

Sam Rubin - *President, Chief Executive Officer*

Albert Miranda - *Chief Financial Officer*

PRESENTATION

Operator

Good afternoon, and welcome to the LightPath Technologies Fiscal 2022 Third Quarter Financial Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal the conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Albert Miranda, Chief Financial Officer. Please go ahead.

Albert 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 those discussed in this periodic SEC filings.

Although the company believes that the assumptions underlying these statements are reasonable, any of them to be proven to be inaccurate and there can 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 reconciliations 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 participants on the call.

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

Sam Rubin

Thank you, Al. Good afternoon to everyone, and welcome to LightPath Technologies fiscal 2021 third quarter financial results conference call. Our financial results press release was issued after the market closed today and posted at our corporate website.

I want to start today's call by providing you a brief update on our company and the vision we have for the future of the business. The area of optics and photonics is at the truly exciting inflection points, technological advances have made solutions in optics and photonics available and applicable to products and services in a wide variety of industries.

Optical solutions are now applicable to products in LIDAR, drones, augmented and virtual reality, medical field, sporting and consumer goods, to name a few. An example of one such application is LIDAR for autonomous drones which we recently announced in collaboration with Apollo Engineering.

We believe that when a technology like photonics moves from being a specialty technology to being integrated into mainstream industries and applications our advantages and domain expertise make us an ideal partner for providing the optical engine for our customers assistance.

Owing the critical differentiating technologies, such as unique materials, high volume molding technology, freeform optics and others position us to both create unique value for those customers and capture that value in the form of stronger profit margins and long-term agreements, engagement with our customers.

Photonics can be embedded in products across many industries, and it is estimated to represent as much as 11% of the global economy. The integration of photonics into mainstream products provides us with a built-in product and customer diversification opportunities.

In the past LightPath was primarily focused on components within the manufacturing supply chain that strategy was designed around the permits that photonics is not widely adopted, and therefore the supply chain was highly fragmented and specialized.

Today, we'll be accelerating adoption of photonics into many applications and industries. Our industry is moving...our strategy is moving away from being simply a component provider to a company focused on providing optical engineered solutions. This means designing and integrating optics, mechanics, electronics and software to provide the complete optical engine to the customer. We are positioning LightPath to be the partner of choice in this exponentially growing field of optics and photonics.

By focusing on our key differentiators, including our design and manufacturing expertise enabled by key optical technologies, low cost and vertically integrated global manufacturing, we believe we can be a leading OEM to customers across the globe.

One area where adoption of photonics is accelerating as the growing need and benefit of infrared imaging, improvement in infrared imaging or opening up new applications to an existing technology, across short-wave, mid-wave and long-wave infrared imaging. Further applications are being applied in border surveillance, drones, maritime and coastal surveillance and critical infrastructure projects.

Infrared imaging has for the most part in base on the use of germanium as the optical material. However, germanium comes primarily from China and Russia with the US importing as much as 95% of the germanium it uses. An alternative to germanium is chalcogenide glass, which we named Black Diamond glass. Through our ongoing production of our Black Diamond 6 Glass BD6, we have gained over the last few years, significant experience in making and using those materials, positioning us is probably the lead manufacture for this kind of material in the US.

Further, receiving's like exclusive license to commercialize further chalcogenide glasses developed by the Navy Research Lab, positions us as the only true source for a portfolio of materials that provide an alternative to germanium.

To that end, I recently traveled to Washington DC, to give a talk about the subject, followed by meetings with DLP and government officials on the topic. We are beginning to see that owning this key technology is well aligned with the growth of infrared imaging and the efforts to build a resilient and robust supply chain in the US.

An important effort that is further emphasized by the recent geopolitical events, all of which reinforces our strategy and indicates that we are in the right place, in the right time and most importantly, heading in the right direction.

To reiterate first, it is owning critical technologies that positions us to capture much of the value in those growing markets. The essence of our strategy revolves around technologies that's critical to the implementation of optical system in those areas. And leveraging those to develop and deliver optical systems and subsystems that produce better infrared images with an overall lower cost of ownership to the customer.

Even as commercialization is happening more broadly, there remains a large addressable market for government and military applications. Our unique technology and expertise were producing and processing the infrared materials, including fabrication of the components and assemblies, lower cost manufacturing in our IR [ph] approved facility in Latvia and technological advancements like our diamond like carbon DLC coating process, which has been qualified for all the US military application, places us in a leading position in this market.

We believe our value proposition makes us an increasingly important partner to commercial development of engineered solutions for Department of Defense Agencies, Defense Industrial Base DIB, point contractors and other infrared optical imaging business.

In October 2021, we announced our entry into the freeform optics arena. Freeform optics involves lenses, we've surface shapes that lack symmetrical attributes, which makes them more challenging to mass produce that provide improved aperture field of view and miniaturization. Freeform optics are becoming a key element in applications such as augmented and virtual reality, AR and VR, infrared and military optical systems, and 3D imaging and visualization.

Many time these systems require the higher performance and more compact form factor, the freeform optics can provide. Allowing increased flexibility and overall size, weight and power optimization. The quality of the material used of the heat producing [ph] smaller and lighter augmented and virtual reality glasses that look more like conventional eyeglasses and less like the bulky AL, VL goggles of today.

Additionally, with freeform optics, LIDAR systems can achieve larger field of use and lower losses, which in turns translate to higher resolution images and ability to extend detection distances. The adoption of freeform optics and such applications has been limited, due to the manufacturing technologies that previously made mass commercialization cost prohibitive. We believe that our technology solves for that.

In January of this year, we announced that our freeform optics won the 2022 Prism Award for manufacturing, which is the Annual International Competition that honors the best optics and photonics product on the market.

In March, we announced that Attollo Engineering chose our freeform optics for use in its in LIDAR product. Attollo's line of laser range finders in LIDAR products provide fast measurement with high accuracy and precision in an ultra-compact package. We integrate our molded freeform optics in their systems, which allows them to achieve optimum performance, while minimizing the number of optical components.

Our freeform optics reduce the cost and weight of their system. At the same time we continue working with more customers and developing free form optics with their applications, and continue working on eight large high opportunity applications, which are in different stages of development and qualification. This is truly an exciting time to be working in photonics and optical solutions, we believe the application of the technologies we use will continue to grow as cusp are reduced and product acceptance increases.

We are really excited about the progress the company has made and the direction we're doing it. We have endured several hurdles over the past year or two, but believes that we are on firmer footing now, and we are at the point where applications for our technology solutions are being...are beginning to be more mainstream.

I will also provide a brief update on the ongoing situation in China before making concluding remarks. As we have mentioned before, although we have taken steps to minimize the business impact from the termination of the previous management, employees and transition to new management personnel in our China subsidiary.

We have experienced some short-term adverse impact on domestic sales in China and the results of operations in the three month period ending June 30th 2021, and the nine month period ending March 31st 2022. These adverse impacts have significantly declined, yes management anticipate they may still have some effects in the next quarters. Domestic sales in China are also being impacted by COVID-19 related shutdowns, which have not directly impacted our factory that have impacted the operations of some of our Chinese customers.

Lastly, I would like to thank all LightPath employees and stakeholders who are working every day to grow the business and achieve breakthrough products and technologies.

This concludes my prepared remarks. Now, I will pass the call over to Al Miranda, our CFO to review financial results for the third quarter.

Albert 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.

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 of business conditions in China during the fourth quarter of fiscal 2021 and into the fiscal year.

LightPath's third quarter financial results are also negatively impacted by expenses associated with the management employee transition at our Chinese subsidiaries, although to a lesser extent than in recent quarters.

On a consolidated basis revenue for the third quarter of fiscal 2022 was \$8.3 million, compared to \$10.7 million in the year ago period. Sales of infrared products were \$3.7 million or 45% of the company's consolidated revenue in this third quarter of fiscal 2022.

Revenue from the PMO products was \$4 million or 48% of consolidated revenue, revenue from specialty products was \$547,000 or 7% of total company revenue. The decrease in revenue from sales of infrared products is primarily due to a decrease in sales to customers...in the industrial market and for temperature sensing applications, which peaked in demand during the third quarter of fiscal 2021.

PMO sales increased 3% in the third quarter of fiscal 2022, compared to the third quarter of fiscal 2021, since the drop off of PMO sales in the fourth quarter of 2021, sales of PMO products in China have improved sequentially each quarter of fiscal 2022, driven in part by other

telecommunication customers, as well as, an increased sales to customers in the industrial, commercial industries. In pre-sales and specialty products were primarily due to NRE projects for customers in the industrial and defense industries during the third quarter of fiscal 2022.

I want to take a moment to expand on the revenue topic as Sam alluded to earlier, revenues from China for the first three quarters have been recovering. However, our lack of sales growth is still related to disruptions in China.

Revenue was down fiscal year-to-date versus last year, year-to-date in China by \$5.1 million, outside of China primarily in the US and Europe, our sales are up by 8% or \$1.6 million. We do see a China recovery on the horizon as bookings are coming back to pre-transition levels. However, with the recent wave of COVID shutdowns, it's difficult to determine precise shipping dates as Sam mentioned earlier.

Further to the revenue discussion, we've taken a strategic approach regarding the quality of revenues. First, we started the process of sun setting certain specialty products they are no longer part of our growth plans. Second, we've taken a more targeted approach to annual volume contracts regarding pricing, which has had the anticipated effect of reducing volume, but increasing the average selling price on the contracts and hence our margins.

Moving on to margins, I'd like to remind listeners that PMO, our margins are typically higher due to our molding technology and capabilities, which enable mass production and a more automated machine process.

Infrared diamond turned lens is historically have a lower margins due to the extra manual production step. But with the growth in our molding technology as applied to infrared products being made from our proprietary BD6 material, the margins will increase over time from both the advantages of the material cost and using a automated molding process.

Gross margin in the third quarter of fiscal 2022 was approximately \$3 million, compared to approximately \$3.9 million in the same period of the prior fiscal year. Gross margin as a percentage of revenue was 37% for the third quarter of fiscal 2022, compared to 36% for the same period of the prior fiscal year. The increase in gross margin as a percentage of revenue was primarily due to product mix, favorable product mix resulting in a slightly higher gross margin as a percentage of revenue, despite the lower revenue level in the third quarter of fiscal 2022.

As we transition the business to engineered solutions, we would expect margins to increase over time. This is due to several factors including multiple lenses required for an assembly, as Sam just described.

Selling, general and administrative costs were approximately \$2.6 million for the third quarter of fiscal '22, a decrease of approximately 187,000 or 7%, compared to the same period of the prior fiscal year. The decrease in SG&A cost is primarily due to decrease of approximately 149,000 of expenses associated with the previously described events that occurred in our Chinese subsidiary, including legal and consulting fees.

Although certain legal activities are ongoing related costs have leveled off, it should cease by the end of this calendar year. New product development costs were approximately 590,000 in the third quarter of fiscal 2022, a decrease of approximately 50,000 or 8%, as compared to the prior fiscal year.

Net loss for the third quarter of fiscal 2022 was approximately \$495,000 or \$0.02 basic and diluted loss per share, compared to \$223,000 or \$0.01 basic and diluted loss per share for the third quarter of fiscal 2021.

The decrease in net income for the third quarter of fiscal 2022, as compared to the same period of the prior fiscal year was primarily attributed to our revenue and gross margin, partially offset by lower operating expenses. Additionally, we recognized \$210,000 of other income in the fiscal third quarter related to the reversal of accruals following the China investigation, and we determine that Chinese subsidiary would not be responsible for those expenses and the reversal is recognized as a gain.

We believe EBITDA is helpful for investors to better understand our underlying business operations. Our EBITDA for the three months ended March 31, '22 was approximately \$647,000, compared to \$1.1 million for the same period of the prior fiscal year. The decrease in EBITDA in the third quarter of fiscal 2022 was primarily attributable to lower revenue and gross margin, again partially offset by the aforementioned \$210,000.

As of March 31st, 2022 we had working capital of approximately \$11 million total cash and cash equivalents of approximately \$5.2 million, more than 50% of our cash and cash equivalents was held by our foreign subsidiaries.

Cash provided by operations was approximately \$352,000 for the first nine months of fiscal 2022, compared to approximately \$3.1 million for the same period of the prior fiscal year. The decrease in cash flows from operations in the first nine months of fiscal 2022 due to the decrease in net income and a decrease in accounts payable and accrued liabilities, partially offset by a reduction in inventory.

We also renegotiated amendment with Bank United extending our term loan until April 2024, the extension further strengthens our intermediary refinancing abilities and enable us to continue along our strategic path.

Our total backlog at March 31, '22 was approximately \$19.7 million, an increase of 1% as compared to \$19.5 million as of March 31st, 2021, compared to the end of fiscal 2021 our total backlog decreased by 8% during the first nine months of fiscal 2022. The decrease in backlog during the first nine months of fiscal 2022 is largely due to timing of the renewal of a large annual contract for infrared products.

Consistent with prior years, we received the renewal of this contract in the fiscal second quarter and began shipping against that contract in the fiscal third quarter. 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 our customers.

With this review our financial highlights and recent developments discussion has concluded. I'll now turn the call over to the operator to begin the question and answer period.

QUESTION AND ANSWER

Operator

We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your telephone keypad. If you are using a speakerphone, please pick up your handset

before pressing the keys, to withdraw your question, please press "*" then "2." Once again that was "*" then "1" to ask a question. And at this time, we will pause momentarily to assemble our roster.

And our first question will come from Gene Inger with ingerletter.com. Please go ahead.

Gene Inger

Hi, Sam and AI, it sounds like an interesting quarter, obviously still in the turnaround mode. And I think it looks like SG&A were actually lower, but it also looks like unit profits dropped, did they for both PMO and infrared?

Sam Rubin

Yes, so the units fluctuate all the time and is really dependent on the mix. We began to see some of the larger customers in China, especially in telecom come back to some degree as we discussed last quarter. And those tend to be lower unit prices on them.

In the infrared, this varied significantly. Engineered Solutions and assemblies can be in 100s of dollars sometimes where individual components can be in the 10s of dollars or less. So we tend to steer away from giving too much importance to the average sale prices, fluctuation, since the mix of product and what we do has been varying considerably more. But yes, thanks for noticing the SG&A and the effects, I think but all this considered, given \$8.3 million top line, results are pretty good and the continued improvement in gross margins even when top line hasn't grown really in that specific quarter, is very encouraging.

Gene Inger

Right, that causes me Sam to ask this, the market cap is so low, of course there's hundreds of companies that are tumbled into almost oblivion at this point, a) it looks like you're making it through this, b) you've been pointing in the right direction, but you're trailing at around 1 times sales and you would think from an investor standpoint that's very cheap. And then, maybe I'm just giving an opinion, but I don't know whether you actually want to eventually shop the company for sale or some sort of a merger, but isn't it essentially undervalued based on even a reasonable growth?

Sam Rubin

Yes, I think first of all, I agree with you that in my independent opinions that it's undervalued and an attractive investment. As a public company, we always open for all options and we haven't ruled out anything, we're not actively shopping the company around. We think that we have, as you said heading in the right direction, a lot of the indications are that we're doing the right thing. Sometimes it's a matter of timing and it happened to be that our discovery of the multi-year effect in China happens at the time where the market was rallying and so we didn't enjoy as much of that rally. And now, while recovery is happening in the time where the market is down, in a bear market. So, sometimes it's just as simple as that.

Gene Inger

So, I guess my last question for the moment, so others can come on, might be, if you have a lot of experience in China, you turned around and built a big company there, in an earlier life, and I wonder whether you envision growing China or eventually with this new focus with the Navy and so on and on free form optics and I enjoyed your discussion, which is on YouTube in Washington. I wonder whether you would eventually drop China, spin it off somehow and concentrate on the domestic scene, which seems to be doing better for the company?

Sam Rubin

Yes, definitely, our investment approach has changed considerably in the last two years since I joined. We stopped investing in China even before all of those events. We rerouted really all of our investments, due to the Latvia operation, which serves the US by being a [indiscernible] facility and now to Orlando where we're essentially doubling our manufacturing space and bringing manufacturing back. That said, the operation we have in China is still very important, it's a good cash generator for us, it's our core technology, which we wouldn't spin off, that would essentially include giving away that technology. But we still see it as a valuable piece of the company just not our strategic long-term focus as much.

Gene Inger

Do you have a timeline and I'll let to go, do you have a timeline on when you envision the new licenses with the Navy and so on? AI and VR actually and you talked about some of that give a timeline when you think this will crystallize in the bookable business?

Sam Rubin

Yes, so two separate things. The Navy...the licensing of the Navy materials, as I mentioned, they really one thing we've seen from the discussions I've had in Washington and with different government officials and such, is that we are really at a perfect timing from that since, the US through the Defense Production Act and through the executive order of the Biden administration on resilient supply chain is heavily investing in developing a manufacturing base in the US and accelerating readiness of new technologies, increasing local capacity and such. So, the US currently imports, as I mentioned 90% of its germanium, that is \$2.7 billion roughly of germanium a year, quarter of that goes into optics around \$600 million, \$700 million of germanium goes into optics in the US.

Chalcogenide is, I think perfect spot to substitute that. Now, we cannot...it's not a one-to-one substitution and you will not completely eliminate germanium. But we are definitely the best option at this point for the US in terms of reducing the dependence on China and Russia for that material. So, I think accelerating that is a key element of many stakeholders, including some of our fine [ph] customers, who are seeking to be involved in helping us accelerate that and bring those materials to market. We are anticipating that in the next few months, the first material might be already released. We're currently already working on copper pipes and we're working with some of the primes, also on designing the material in and seeing the encouraging results that we have. But it's really a key element here, I think in much of what the US is looking at.

In terms of the free form optics, that's a bit of a different play in the sense that this is a technology that we've already developed and matured enough now is the time for the customers to take that in and to utilize it. We've mentioned in the last months that Attollo Engineering, for example, have already adopted free form optics into their LIDAR products and it looks very promising and successful, they have some very unique products in the sense of being able to very quickly monitor the location of drones, of fully autonomous drones making sure they don't collide with other and so on and the free form optics are really a key elements there.

In other places, we've shipped prototypes already to AL [ph] countries, for example, have already our free form optics in prototypes, others are at different stages of it, LIDAR is becoming a bigger piece there, but that will take longer, because most of the free form optics is enabling a cutting-edge application to such a degree that that application needs to first be adopted and when its owned commercial success, before the free form can scale up with. And it looks very encouraging.

Gene Inger

I don't want to, well to say, if you have time for one quick, you didn't give any color on two areas that I would be interested in in the past. One was low orbiting satellites such as SpaceX system, there is even talk about the China wanting to intercept that and so on. And I'm wondering, speaking of intercepting whether you're involved in that and whether you're involved with the new laser interception systems in Israel, which is infrared and laser to try to intercept enemy rockets?

Sam Rubin

Yes, yes. Obviously and someone who grew up in Israel, I'm very proud of that system then seeing it. I can't comment on specific systems and technologies of course, I can say our business with Israel has grown exponentially in the last half-year or so. And I feel very good about it in a great part it is because of the investments we made in the Latvia operation, enabling them to really service customers from there far, far better than we could before. And we have involved in multiple low earth orbiting and space project all the way from optical communication projects to thermal cameras and for detection cameras, definitely mid-wave cameras are playing a major role today in detecting supersonic missiles through lower for orbiting. The government and the Pentagon has decided to [indiscernible] money just recently, it was in the news, to deploy a whole satellite network related to that. And that's a very exciting application that we see for mid-wave another place where chalcogenide glass plays a major role. It's really being a thermal and very low weight, compared to alternatives makes it a great, great material for any space applications, especially for low earth orbiting camera systems.

Gene Inger

Thank you. I appreciate the enlightenment, I haven't heard anything lately from you about that.

Sam Rubin

Absolutely, yes. And we also just closed the loop on that. We have announced previously that we have grants from Space Florida from European space agency's and a couple of other projects and such, all related to accelerating our technologies for use in space, especially all the chalcogenide materials to replace germanium and to be used in very specifically for low earth orbiting satellite.

Gene Inger

I suppose as a footnote to that, you could mention whether ISP optics, your Latvia operation is involved with the drones that are going to Ukraine now or coming from Turkey and whether or not you see a surge in business in Europe as a result of this.

Sam Rubin

I'd say that we don't know where our product end up always. I can definitely say that we proudly deliver products to multiple UAV and drone companies that hopefully make good use of it. I can say that our expansion in Latvia, adding the optical coating they're making it vertically integrated and independent of US manufacturing for that sense, aligns perfectly in timing to all the increases in defense budgets in Europe now and to an increase in demand that we are seeing already in terms of designing our products into defense applications. The Latvia operation besides being [indiscernible] operation can also serve European defense companies now by being completely vertically integrated having coating and assembly capability there, which is something that we are confident is going to deliver significant growth in Europe for us in the infrared imaging.

Gene Inger

Thank you, sir.

Sam Rubin

Absolutely. Good to hear from you, Gene.

CONCLUSION

Operator

Once again, if you would like to ask a question, please press "*" then "1." This concludes our question and answer session. The conference has now also concluded. Thank you for attending today's presentation and you may now disconnect.

UNEDITED