LightPath Technologies, Inc.

Fiscal 2023 First Quarter Financial Results Conference Call

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CORPORATE PARTICIPANTS

Sam Rubin - President, *Chief Executive Officer*

Albert Miranda - *Chief Financial Officer*

PRESENTATION

Operator
Good afternoon, and welcome to the LightPath Technologies Fiscal 2023 First 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 "*" followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask question, you may press "*" then "1" on your telephone keypad. 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 that is discussed in our 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.

Sam will begin today's call with an overview of the business and recent developments for the company. I will then review financial results for the quarter. Following our prepared remarks, there will be a format question-and-answer session.

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

Sam Rubin
Thank you, Al. Before I begin, I just like to inform everyone that due to internet shortage in Orlando, or internet outage, we are on cell phone, so excuse us if there is any quality issues with the audio.

So, good afternoon to everyone and welcome to LightPath Technologies' fiscal 2023 first quarter financial results conference call. Our financial results press release was issued after the market closed today and posted on our corporate website.

As can be seen from our sales number for the quarter, LightPath this quarter faced multiple headwinds starting from Hurricane Ian, affecting our shipments in the last few days of the quarter, a slowdown in China and the war in Ukraine. The hurricane was sufficiently intense to force LightPath to close operations at our Florida facility for the last three days of the quarter. The facility closure resulted in a delay in shipments, which impacted revenue for the last week of fiscal 2023 first quarter.

An initial assessment is that the fiscal first quarter revenue could be negatively affected by $400,000 to $700,000 due to delayed orders shipping, all of which have simply shifted into the following quarter without losing any of this revenue. In the past quarters we have acknowledged a slowdown in China's economy affecting demand for LightPath's product. The first fiscal quarter of 2023 saw a continuation of this trend with demand in China lagging. As mentioned in our record backlog disclosure earlier this quarter, demand has been picking up significantly in other regions for future shipments starting in one to two quarters, but that is not yet visible in our sales numbers for first quarter of the fiscal year.

Sales inside China for this quarter represented roughly 13% that is one three percent, of LightPath's revenue for the quarter. That is down from about 30%, three zero percent, in fiscal 2022.

We have, however, began preparing for this day for a while now. And as a reminder, shortly after I joined in 2020, we conducted an in-depth strategic analysis and have concluded that the pure components play is not sustainable for us and that market is getting too crowded. Since then, we have been plotting a new course and moving away from our dependence on components and putting our resources and growth elsewhere, in particular in infrared optics and in added-value engineered solutions. And while we did not expect sales of components in China to shift so quickly, the combination of the lockdowns in China, the economic speculation and the geopolitical events have accelerated this shift proving to us that our new strategic direction which we began implementing two years ago is the right direction for us.

Now, having said that, I do want to revisit where LightPath is going. In the past few quarters, we discussed our transition to a provider of optical solutions from a manufacturer of components. We have significant engineering and product knowledge built out over the years to provide our customers with sufficiently compelling solutions for them to partner with us. Product development will be critical in our transition to a solutions provider.

We continue to make substantial progress in that business transition and are excited about what we will announce in the coming weeks and months. Last quarter we discussed our domestically produced Black Diamond glass as potential to our transition to a solution provider. These materials make a cheap domestically produced product and allow new applications such as multi-spectral imaging. These are obvious benefits over traditional crystalline infrared materials like germanium, which is largely sourced from China and Russia.

Over the last year, we have been collaborating with different government agencies and key customers on advancing our Black Diamond glass and moving into production some of the new materials we have developed based on the license from Naval Research Laboratory.

This morning, for example, we announced that there our flagship Black Diamond material, named BD6, passed radiation testing and is being qualified for use in space. This is part of a project financed by the European Space Agency and announced by us about a year ago. Similar to that, we have ongoing projects and commitments from different government agencies, primarily in the DoD, Department of Defense.

For the integration of our materials into new systems, both for superior performance and to reduce the dependence on germanium, expect LightPath to announce development of new solutions, leveraging the potential of our Black Diamond material, which allow our customers to achieve results representing leaps forward in optics in the coming weeks and months.

While we look forward to exciting news on the product development front, we are also seeing exciting development on the business front. We announced that LightPath reached a $24 million backlog in August. While backlogs fluctuate over time, we see them as the best indicator for future revenue. At the end of the first quarter, our backlog remained near historically high levels at $23 million.

Looking deeper at the backlog, we see some beneficial trends. The backlog is more skewed now towards defense and commercial customers in US and Europe than it has ever been before.

Additionally, the backlog remains comprised of a significant portion of solutions-oriented orders, the bulk of which are scheduled to begin deliveries in our third and fourth fiscal quarters of this year. I have previously spoken also about the number of key opportunities we're working on, that involve new technologies and products and each one of those key opportunities could potentially be a 10% or more customer.

Along those lines, I would like to update that while a couple of those opportunities have fallen through, three of the opportunities have completed customer qualification and are awaiting customer production orders. While two of the opportunities have grown further than our initial expectations and represent our opportunities that could each be a game changer to our revenue. We will continue to update on those and hopefully be able to announce soon the transition of some of those into production.

Despite some external headwinds and near term cost pressure, the company's outlook and growth prospects are extremely bright. Our Black Diamond glass, as well as many other technological innovations, have the potential to revolutionize our product portfolio and are beginning to do so already. We are actively developing solutions built on that platform to provide a complete engineered solution that was impossible or much harder to achieve before.

I want to thank our employees and stakeholders who have continued to work diligently through the various transitions and hurdles we have endured. We see a bright future and growing company because of their dedication and hard work.

And with that, I will now turn the call over to our CFO, Al Miranda to review our first quarter financial results.

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. I encourage you to visit our website at lightpath.com to access these documents. I will discuss some of the primary financial performance metrics and provide additional color on them to better assist investors in analyzing the company.

On a consolidated basis, revenue for fiscal first quarter was $7.4 million compared to $9.1 million in the year ago period. Sales of infrared products were $3.6 million or 49% of the company's consolidated revenue. Revenue from PMO products was $3.3 million or 44% of consolidated revenue. Revenue from Specialty Products was $0.5 million or 6% of total company revenue. The decrease in infrared products revenue is primarily driven by sales of molded infrared products particularly to customers in the China industrial market. Sales of diamond-turned infrared products also decreased, also attributable to customers in the industrial market.

Sales from PMO products were $3.3 million compared to $3.8 million in the same period of the prior fiscal year. The decrease in revenue is primarily attributed to decreases in sales through our catalog and distribution channels, as well as sales to commercial customers. The majority of the decrease in sales through our catalog and distribution channels is due to the termination of our distribution agreement in Europe during the third quarter of fiscal 2022. We are no longer accepting new orders through this distributor; they are now soliciting and receiving orders directly from the end customers.

This transition will continue through the third quarter of fiscal 2023, as we will continue to ship distribution orders that were in place prior to the contract termination. The remainder of the decrease in PMO product sales is related to customers in China, across all of the industries we served there. Sales in Specialty Products was $0.5 million compared to $0.4 million in same period of the prior fiscal year. The increase was primarily driven by non-recurring charges billed to a customer during the first quarter of fiscal 2023.

Moving on to margins, I'd like to remind listeners that PMO margins are typically higher due to our molding, which enables mass production in a more automated machine process. Infrared historically was more manually produced, but with the growth in our molding technology as applied to infrared products being made from our proprietary BD6 material, margins will increase from both the advantages of the material cost and using an automated molding process.

Gross margin in the first fiscal quarter 2023 was approximately $2.2 million compared to approximately $3.2 million during the prior fiscal year-over-year period. Gross margin as a percentage of revenue was 30% during the quarter compared to 35% for the year-over-year period.

Although this quarter had a similar product mix to first quarter 2022, the decrease in gross margin as a percentage of revenue is primarily due to the significantly lower revenue level with less contribution towards fixed manufacturing costs. Maintaining a gross margin of 30% at this low revenue level reflects the benefit of a number of the operational and cost structure improvements that we have been implementing.

Selling, general and administrative costs were approximately $2.6 million for the first quarter of fiscal 2023, a decrease of approximately $231,000, or 8%, compared to approximately $2.9 million in the same period of the prior fiscal year. The decrease in SG&A costs is primarily due to a decrease of approximately $300,000 of expenses associated with the previously described events that occurred at our Chinese subsidiaries, including legal and consulting fees.

Net loss for the first quarter of fiscal 2023 was approximately $1.4 million, or $0.05 basic and diluted loss per share, compared to $632,000, or $0.02 basic and diluted loss per share, for the same quarter of the prior fiscal year. The decrease in net income for the first quarter of fiscal 2023, as compared to the same period of the prior fiscal year was primarily attributable to lower revenue and gross margin, which was partially offset by lower operating expenses and income taxes.

We believe EBITDA is helpful for investors to better understand our underlying business operations, our EBITDA for the quarter [indiscernible]. The decrease in EBITDA in the first quarter of fiscal 2023 was primarily attributable to lower revenue in gross margin, partially offset by lower operating costs. As of September 30, 2022, we had working capital of approximately $9.2 million and total cash and cash equivalents of approximately $4.3 million of which greater than 50% of our cash and cash equivalents was held by our foreign subsidiaries.

Cash used in operations was approximately $416,000 for the first three months of fiscal 2023, compared to approximately $1.6 million for the same period of the prior fiscal year. Cash used in operations for the first three months of fiscal 2023 reflect a higher net loss in the comparable period, with an outflow of approximately $69,000 from the net change in operating assets and liabilities. Whereas the first three months of fiscal 2022 reflect an output of approximately $2 million [indiscernible] in operating assets and liabilities.

This is largely due to timing. Portion of the decrease in accounts payable and accrued liabilities during the first three months of fiscal 2022 was due to the previously described events that occurred at our Chinese subsidiaries with certain expenses were accrued as of June 30, 2021, many of which were paid during the first three months of fiscal 2022. The first three months of fiscal 2022 also reflected an increase in accounts receivable due to higher sales in the previous sequential quarter, whereas for the first three months of fiscal 2023 reflect a decrease in accounts receivable due to the lower sales than the previous sequential quarter.

The increase in backlog during the first three months of fiscal 2023 was largely due to a $4 million supply agreement with a long time European customer of precision motion control systems and OEM assemblies. The new supply agreement will go into effect in the second half of our fiscal year and is expected to run around 12 to 18 months. In addition, orders received for several other significant long-term projects with customers in the US and Europe.

I'd like to add some commentary. A $7.4 million revenue quarter is a very low figure. There are three events that contributed to the sub-$9 million quarter. First was shutting down for Hurricane Ian. Second is we ship the end of our annual contract with a key European customer, which typically renews in November. And the third was the ongoing drop in demand in China, which Sam discussed, and we've mentioned before. The first two are what I would consider normal business, the hurricane is a delay, and the annual contract will shift at an accelerator rate all year, though it concluded early. The latter is unfortunately shaping up to be the new norm in China and is being addressed in a very comprehensive way.

Our current forecast backed up by our backlog is a strong indicator that Q1 will be an anomaly for this fiscal year. As we've said, war, recession, even hurricanes are headwinds and wild cards. And to be straightforward, China is in a recession and the current government policies will likely keep it there for a while.

That said, we do expect growth in Europe and the US particularly in defense, aerospace and specific industries. So we remain cautiously optimistic about revenue even with recession headwinds and a bad quarter. Investors and analysts often ask about margins as an indicator of the company health and ability to produce positive results. 30% gross margin this quarter certainly would invoke the question of what to expect.

As a point of comparison, I went back several years in search of a comparable quarter. In 2019, we had a $7.5 million quarter with 30% gross margins. In that fiscal year salaries were lower, raw materials were cheaper, utilities were less than half of today's price and there was no recession in China. The improvements we've made in cost efficiencies and yield is hidden in the $7.4 million sales figure, but also hidden is a reason to be somewhat optimistic about our future results when revenues are normal levels and growing. So with this review, our financial highlights and recent developments concluded.

I'll now turn the call over to the operator to begin the question and answer session.

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 pickup your handset before pressing the keys. To withdraw your question, please press "*" then "2". At this time, we will pause momentarily to assemble our roster. Our first question will come from Scott Buck with HC Wainwright. You may now go ahead. We'll move on to the next question.

Our next question will be Brian Kinstlinger with Alliance Global Partners. You may now go ahead.

Brian Kinstlinger
Sounds like we're all managing multiple conference calls at once. So, I'm going to start with the exiting of your distribution partner in Europe. Maybe you can provide some detail behind what led to that. I don't know if you've shared it before, maybe I forgot. How much revenue did that distributor help generate in the trailing 12 months? And then how do you plan to replace that revenue or reconnect with those customers?

Sam Rubin
Yes. So great question and thanks for joining today, Brian. The work on replacing the distributor has been ongoing since I joined. We announced opening an office in Europe as early as I think a year and a half ago or maybe even two years ago in preparation for that and have been preparing and negotiating our way to direct sales. We now, I believe, have not only not lost any customer since then, but actually have significantly grew sales in Europe since then. And there's two reasons for it, one, the distributor was focused really on a few specific areas, mainly in industrial customers and growth from the distributor was in stagnation, wasn't really growing. They achieved nice growth many years ago and have been sitting on it since then.

Once we replaced a distributor, a few things happened. First of all, our margin for those products went up because we're not paying any more the 15% or 20% discount or sharing of profit with the distributor. The costs related to selling directly have already been embedded in our SG&A for a couple of years now. So there's no new costs related to that and since we have already a facility in Latvia that is part of the EU, we essentially funnel all our sales in Europe through that facility and are able to really shift domestically inside the European Union from there without any problem whatsoever; so very, very little added cost.

So our margins went up because we're not paying a distributor anymore. Our sales have gone up because, one, the new team is highly energized and wants to drive that. And two, we are focusing much more now on defense business, which we started working towards defense business in Europe about a year and a half ago. Obviously, the war and everything happening there has really been a driver for that. So I'd say that overall our sales in Europe are growing really nicely and our margin from those sales are growing too.

Brian Kinstlinger
Okay, I just wanted to make sure, and then I understood in your prepared comments, I joined a few minutes late, I thought you said that losing at the end of this distribution partnership led to some lower revenue, but you say you're growing faster, so is it you lost some, but now you're growing what you've got faster. Is that what you're trying to communicate?

Albert Miranda
Yes. So Brian, sorry, that's probably my fault. It was a little worry the way, the way I said that. It was not my intention to say that our sales are going down. It's more regarding categorization. We don't have…we don't have as much catalogue and distribution sales in Europe, but it's being replaced by direct sales in the verticals like defense and commercial like Sam would say, that's my fault. I should have…I should have worded that.

Brian Kinstlinger
No worries. Excellent. And then you mentioned three what I believe were freeform products that have completed qualifications. Two gone further than you expected and if I'm using your words, could be a game changer. Help us with the timing of when we would know if it in fact is a game changer and how do you define a game changer of $2 million, $5 million per year, I mean could you talk about some...

Albert Miranda
I would say, yes, absolutely.

Brian Kinstlinger
In the past you've talked about there's a big difference if it's a new product for the next generation of existing product, maybe help us with all of that, sorry?

Sam Rubin
Yes. No problem whatsoever. So first of all not all of them are necessarily Freeform Optics. Freeform Optics is a key technology that sort of gave us a second wind for the PMO for the molded optics, but it's one of multiple technologies that we use as differentiators. The Black Diamond glass, the Freeform Optics, the Coatings, the DLC and many more. So of those projects, I'd say the tools that are potentially game changers in my wording are actually not Freeform Optics. They are both in the Infrared Optics. And when I say game changer, I mean something's that can…is supposed to very quickly scale according to the timelines that we have, meaning within two, three years scale to somewhere between $5 million to $10 million a year revenue. So usually, I refer to those as 10% customers and I feel that something in those numbers are more of a game changer. One of them is in automotive, another one is in defense. They're both projects we have been working on for well over a year, very extensive qualification, in both the defense and automotive, but in both of them once you're there you are in it for years of course. The automotive in particular is interesting because it's a leading car company that at first is going to roll it out a few models but later on plans to have it in all of their models.

Brian Kinstlinger
And lastly, when…help us with a timeline will you know that the year…you know six months, a year will it take you to know. Where are we in timing?

Sam Rubin
I'd expect to see a…I'd expect to see us signing a supply agreement for both of them and announcing qualifications in the next six to 10, maybe 12 months. The supply agreement will not necessarily be the purchase order itself. It could be a supply agreement for five years stating the range of quantities and such, but there's already a commitment that we are the supplier for those parts.

Brian Kinstlinger
Okay. Last question I've got and I'll jump back in the queue. With your…I missed the start of the call, but with your BD6 press release, I think at least since I've joined the LightPath story,

BD6 hasn't taken off for reasons we've discussed on the calls in the past yet. Does this open a door for that to take off? What's the timing for that? You start replacing that with Germanium? Just help us understand what this means to the business and the timing of it?

Sam Rubin
Absolutely, I think this announcement is very, very important on a strategic level but not necessarily what people think of, meaning absolutely is a space for orbiting missions and so on is a good market. It's a market we're in. We're going to push even further in. But to me what's made special about this announcement is that the government organization has decided to spend money with us, specifically to qualify the material to replace Germanium. And we've been singing that song or talking about this for a long time, about the dependence, the risk, the very, very significant supply chain liability risks that the DoD here and other governments have. .And this is the fact that they decided to put their own money into that and to now essentially…it's not formally qualified because they need to finish the project, but it's part, the most critical part of the radiation part, the hardest the radiation resistance. The fact that they are doing that is an indicator we have them on board. Are they going to now go and really switch everything to BV6? No, and it's not needed. What's important is that they will reduce the exposure and the amount of germanium significantly. And they understand that we have the solution for that.

Brian Kinstlinger
Great. Thank you very much.

Sam Rubin
Thank you, Brian.

Operator
Again, if you have a question, please press "*" then "1." Our next question will come from Gene Inger with ingerletter.com. You may now go ahead.

Gene Inger
Hi, Al and Sam. And I first congratulate you on being brave enough to do a conference call with the kind of results that have been…which we knew were forthcoming. My first thought would be that for investors, because the questions have been asked about some of the products and about Europe that I would have, but for investors, this has been sort of a half pregnant hazy picture with LightPath always trying to develop the baby, but somehow never delivering. If I take the questions that I've already heard, I would say that you are expecting delivery. Basically, you are in about the first trimester right now. And you are pre-announcing a good quarter later in the year.

Albert Miranda
Yes, I think….first of all, I agree and understand what you're saying and this definitely has been a roller coaster ride and more than one thing definitely during our term and over the years here. We're excited about a number of things, and that is both in the pure financial direction of things and strategically. Absolutely seeing that the sales in China going down is painful, but realizing now that the decision we made two years ago and the somewhat painful directions that we've taken to sort of mitigate that is paying off, kind of makes us a bit pleased in the sense of we're far better off than if this had caught us by surprise, and now we would need to start changing directions. So we've been working on this for two years.

And different activities are coming to fruition. There is some really, really significant and exciting business opportunities that are at very advanced stages that we, you know, hopefully will have, very shortly some announcements on. Some of them could take two years to mature to full revenue, but they are a completely different type of revenue and relationships than LightPath has had in the past. So, I think we are in the right time with our technology, we have the geopolitical events, we have China, we started preparing for this two years ago. Sure, we could have done it faster having known that now China is going to fall apart. But we're definitely at a far better place than we were say half a year ago.

Gene Inger
By the way, while I don't think that China will be what it was before, after what they have done, I suspect that after the meeting with Xi and Biden, you might be surprised that they commit to improved trade relationships, but certainly not when it comes to national security issues, which takes me to my next question. And I have no choice, but to ask you, and you may have seen, I've referred to another company in Orlando that is in the photonics field, not infrared lenses per se, but they are involved in radiation hardening processors. And we're talking about space for anyone that's listening, not nuclear conflict, but the space aspect, and that means satellite communications. And they referred….I'm talking about SkyWater. Do you know them? I know you don't like to talk about specific customers, and I can speculate whether it's SkyWater, whether it's SpaceX, can you discuss relationships with either?

Sam Rubin
I would say that we work with a great number of companies and are deeply involved in a great number of projects related to space. When it comes to radiation, one wants to also look at what is the lifespan of a satellite and location, the further away you go from earth the stronger the radiation, in the very low earth orbiting such as satellite SpaceX, which is also designed to last only two or three years, the radiation is not as much of an issue there. However, with geo-synchronized, and with defense-related satellites and so on, the radiation is much more significant. But in either case we work on multiple space projects, many of them, many if not almost all of them, are related to imaging from space. And this starts from weather satellites all the way to agriculture, detection of different events on the ground in different wave bands, both long-wave, mid-wave, shortwave, and so on.

Gene Inger
Would that include by any chance target acquisition systems for the upgraded version of Lockheed Hellfire, and so on?

Sam Rubin
It could very well be. Definitely, there is a lot of talk about it, and this is public knowledge, so I wouldn't be sharing anything that isn't known, but with sonic missiles and all the work towards that, really one of the only ways to identify them after launch and to track them is using mid-wave and long-wave thermal imaging. And there is a lot of work being done towards satellites related to that. The Missile Defense Agency announced recently I think three or four satellites that are going to be dedicated for that, and they're going to be the test bed for that.

Gene Inger
And finally, you obviously would not have come to the company nor AI if you didn't see the potential and the stock option benefits down the road. Do you see this as a company that can emerge into something that not only justifies these quarterly calls but becomes an asset that becomes attractive? In other words, can you scale on your own as these contracts develop, or do you think you'll need a larger partner that works with DoD?

Sam Rubin
Yes. No, absolutely we believe in the company, which is why we also decided recently to take more of our compensation in the form of equity. And I think that sends the proxy, which is going to be to vote on this next week. And we strongly believe in it and want to align ourselves to it. We believe that we're able to grow along this path ourselves, and part of the reason for that is the timing on what we're doing is so well aligned with the priorities of the government and the DoD that we're seeing multiple places where we are getting and going to receive support from the government. We have strong commitment letters from customers inside the government, whether it's in the army or air force, guaranteeing essentially that they are going to switch over to using our Black Diamond materials the moment they are ready to reduce the dependence on germanium.

With that in mind, the DoD as cumbersome as it is, is pretty good at supporting small businesses, especially if they are aligned to strategic objectives. And so we are working very closely with Defense Logistics Agency, Air Force Research Lab, Army Night Vision, Missile Defense Agency, and many more on these efforts, just like the European Space Agency. And those are funded efforts with not only short-term funding, but also long-term commitments with it.

Operator
Our next question will come from Scott Buck with HC Wainwright. You may now go ahead.

Scott Buck
Hey guys, good afternoon, and thanks for taking my question. Just one for me today, you guys have done a really nice job managing the costs given all the headwinds on the revenue side. I'm curious, if the current environment were to last for an extended period of time, whether or not there is some additional levers you could pull there to continue to minimize cash burden?

Albert Miranda
So Scott, yes, the answer is yes, there are other levers.

Scott Buck
Okay, perfect. That's it for me guys. Thanks Al.

Operator
It appears there are no further questions. This concludes our question-and-answer session. I would like to turn the conference back over to Sam Rubin for any closing remarks.

CONCLUSION

Sam Rubin
Thank you. I appreciate everyone's participation and patience with us as we continue to turn around the company and really take it in a new exciting course. I look forward to seeing everyone next week in our Annual Shareholder Meeting on Thursday at 11:00 AM Eastern Time. And if you haven't yet, please don't forget to vote for our proxy. Thank you and good day.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.