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Skywater Technology, Inc. (SKYT)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is David, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the SkyWater Technology Fourth Quarter Fiscal Year 2021 Earnings Call. Today's conference is being recorded. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you, Heather Davis, Investor Relations. You may begin your conference.

Heather Davis

Senior Director-Investor Relations & FP&A, Skywater Technology, Inc.

Good morning, and welcome to SkyWater's fourth quarter fiscal 2021 conference call. With me on the call today from SkyWater are Thomas Sonderman, President and Chief Executive Officer; and Steve Manko, Chief Financial Officer. I'd like to remind you that our call is being webcast live on SkyWater's Investor Relations website at IR.SkyWaterTechnology.com. The webcast will be available for replay shortly after the call concludes.

During the call, any statements made about our future financial results and business are forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially. For a discussion of these risks and uncertainties, please refer to our filings with the Securities and Exchange Commission, including our earnings release filed on Form 8-K yesterday and our prospectus filed April 22, 2021. All forward-looking statements are made as of today, and we assume no obligation to update any such statements.

During this call, we will discuss non-GAAP financial measures. You can find a reconciliation of these non-GAAP financial measures to GAAP financial measures in our earnings release, which is available on our Investor Relations website. Unless noted, all comparables referenced today are versus the prior year, or fourth quarter of fiscal 2020.

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With that, let me turn the call over to Tom.

Thomas Sonderman

President, Chief Executive Officer & Director, Skywater Technology, Inc.

Thank you, Heather, and good morning to everyone on the call. Today, I will briefly cover our high level Q4 financial results and then highlight the exciting dynamics we see in our business, including the progress we are making on some of the emerging technologies expected to drive our long-term growth.

Total revenue in the fourth quarter was up 15% year-over-year, excluding the $2.5 million benefit of the extra operating week in Q4 2020 and tool revenue in both Q4 of this year and last year. On a reported basis, total revenue of $38.5 million decreased 3% year-over-year.

SkyWater continues to win new business, signing nine new advanced technology programs in the fourth quarter. Our customer count has increased by over 70% from our IPO in April. In addition, our sales pipeline grew by over 50% in 2021.

Non-GAAP cost of revenue of $40.4 million increased 16% year-over-year. This increase was driven by more activities, labor inflation, supply chain constraints and investments in our strategic platforms. As demand for our Technology as a Service model increases, we have continued to hire at our best to support increased activities. In addition to head count increases, SkyWater, like others in the semiconductor industry, is seeing wage inflation.

The supply chain for substrates, equipment, chemicals and gases remains congested with rising prices. In Q4, for both wafers and nitrogen, we added additional sources at a higher cost to complement the output from our primary suppliers. Our cost of revenue also contains strategic long-term investments in our radiation hardened and heterogeneous integration platforms.

In addition, we have continued R&D investments to build capabilities in our targeted growth platforms, including power. We also continue to aggressively expand our sales team and transition to a public company, both of which increased SG&A. Adjusted EBITDA was negative $4.9 million in the fourth quarter.

Now I will provide an update on our four growth areas. The six biohealth programs won in Q2 of this year continue to move rapidly through our TaaS funnel in preparation for market entry. These programs are expected to enable novel innovations in rapid diagnostics, genetic sequencing and various consumer and clinical medical device applications.

Last month, Rockley Photonics announced the result of a study demonstrating their noninvasive wrist-worn sensor. This is a major milestone towards incorporation of Rockley's unique biomarker platform into consumer health wearables devices. Several of our other biohealth customers have significant commercial and regulatory milestones planned for 2022. We remain highly enthusiastic about our strong pipeline for biohealth as we continue to demonstrate SkyWater's differentiated capabilities in this rapidly growing market.

Earlier this year, we announced that through an ATS collaboration with our customer, Applied Novel Devices, our A&D, we achieved an industry breakthrough in power MOSFET performance. By using a novel channel engaged structure that substantially reduces parasitic switching losses, we have co-created a new class of power MOSFETs that pushes the viability of silicon-based switching into a higher frequency range, often written off is only serviceable by wide bandgap technologies.

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This new technology will deliver higher efficiency for voltage and signal conversion in a wide range of industrial power management applications, including switch mode power supplies. We are currently working with A&D and our initial customer to prepare for the production ramp of these new devices and the expected new revenue for our Wafer Services business.

As part of our technology licensing agreement with AND, SkyWater is building a reference design platform using this new device class. With this capability, SkyWater can directly engage with a host of other power management companies, allowing us to hasten the adoption of this exciting new green technology across the industry.

We continue to make good progress in all three elements of our heterogeneous integration technology roadmap, which we previously referred to as advanced packaging. This includes silicon interposers, wafer bonding and fan-out wafer-level packaging. We achieved first full flow production earlier this month, an important customer milestone for our silicon interposer program. We expect to achieve the full qualification of our Phase 1 interposer in the first half of 2022.

We are also planning for a Phase 2 and Phase 3 milestones this year, which include TSV and RDL and corporation. The production readiness at our Florida facility, including the launch of our ISO 9000 and trusted accreditations, continues to rapidly advance after only one year of taking over the operation. A number of exciting new engagements are also progressing well through our customer onboarding process, driving additional revenue for the site in 2022.

In November, we established our presence in Indiana at WestGate@Crane Technology Park adjacent to Crane Naval Center. Navy Crane is a naval laboratory and a field activity of Naval Sea Systems Command. The center is responsible for multi-domain, multi-spectral, full life cycle support of technologies and system enhancing capabilities while serving as the lead in the United States' Trusted Assured Microelectronics program. Our physical proximity to Navy Crane at this growing epicenter for the Department of Defense's microelectronics community continues to cement SkyWater's role as the trusted foundry partner.

During the fourth quarter, we achieved an important milestone with our RH90 technology platform by delivering encouraging radiation performance test results on our first fully integrated wafers with copper interconnects. The eventual production of these highly valued Rad-Hard ASIC is of national importance for both space-based and defense applications, and SkyWater continues to play a crucial role in its enablement.

On Tuesday, January 25, the United States House of Representatives took an important action in advancing the federal funding for reshoring in the semiconductor industry that have previously been passed by the US Senate and referred to as the CHIPS Act. We are encouraged by the government's continued focus on incentives for domestic microchip fabrication, research and development and heterogeneous integration. The SkyWater team continued to assist the US government by responding to the Department of Commerce's request for input and administering a CHIPS-like grant program.

Additionally, we continue to enjoy increased support from our state leaders in Minnesota, Florida and Indiana, where we have ongoing dialogues with the governors in these states to articulate SkyWater's requirements for expanding in state [indiscernible] (09:51) and creating a vigorous high tech business environment. We intend to be a leader in rebuilding our nation's manufacturing infrastructure for the advanced technologies that will be the major drivers in our industry for years to come.

The amazing work being done by the employees of SkyWater is critical to our customers, our shareholders and our nation. We will continue to decisively invest in our Rad-Hard power and heterogeneous integration platforms

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to fuel future growth and further our ability to co-create the technologies of the future with our customers in a post Moore's law era.

For 2022, we expect revenue growth near our long-term goal of 25%. This is supported by 50% year-over-year growth in our sales pipeline, strong program design wins throughout 2021 and the expected movement of our radiation hardened platform later this year to the productization phase. The expected revenue growth in 2022, coupled with the company's robust strategies to mitigate current supply chain dynamics, are expected to position us well for gross margin expansion later this year.

I will now turn the call over to Steve for more information on SkyWater's financial performance in our recently completed quarter. Steve?

Steve Manko

Chief Financial Officer, Skywater Technology, Inc.

Thank you, Tom. Total revenue for the fourth quarter of 2021 was $38.5 million. Year-over-year revenue grew 15% when excluding tool sales in both Q4 and extra operating week in Q4 2020. Advanced Technology Services revenue was $24.4 million and Wafer Services revenue was $14.2 million. ATS revenue was, again, impacted by the customer program that was being reconstructed and is expected to recommence in 2022. This is the same program that we previously discussed during our second and third quarter earnings calls. This contract contributed a $2.4 million in fourth quarter 2020 and $23 million in fiscal 2020.

Also, as previously communicated, we have a large multi-year ATS program originally scheduled to be completed in the fourth quarter of 2021 that was pushed out into early 2022. This moved revenue recognition from the third and fourth quarter of 2021 into 2022.

Customer funded tool revenue, which is included in our ATS revenue in the fourth quarter of 2021, was $1.1 million compared to $4.9 million in the fourth quarter of last year. As anticipated, Wafer Services revenue of $14.2 million increased from 2020 as we continue to ramp production. GAAP cost of revenue was $55.2 million, an increase of 52% year-over-year. However, cost of revenue includes a $13.4 million inventory write-down for temperature differential sensing wafers. We continue to seek an alternative buyer for these wafers. SkyWater does not have any remaining financial exposure for this one-off contract.

Non-GAAP cost of revenue was $40.4 million compared to $34.9 million in the fourth quarter of 2020. GAAP gross loss was $16.6 million decreasing from gross profit of $3.5 million in the fourth quarter last year. Gross margin of negative 43.1% declined versus prior year of 8.9%. Non-GAAP gross loss was $1.9 million compared to gross profit of $4.8 million in the fourth quarter last year. Non-GAAP gross margin was negative 4.8% and 12.2%, respectively.

Cost of revenue increases were driven by three primary factors: labor, supply chain and continued investments for long-term growth. In addition to hiring ahead of the volume ramp at our Minnesota Fab, we've seen wage pressure for manufacturing roles. We've increased our hourly wage in July to attract and retain talent, and there is additional wage pressure in the manufacturing labor market we expect to persist throughout 2022.

Labor increases accounted for half of the sequential increase in non-GAAP cost of revenue in the fourth quarter. Supply chain remains tight in many areas as SkyWater, like other semiconductor companies, is growing to meet market demand and chip shortages. As a result, we are experiencing higher costs for starting materials, utilities and freight.

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In Q4, freight costs were up over 50% compared to the prior four-quarter average. Our expectation is that these higher costs will continue in 2022. We continue to make investments for the long-term growth of the company by building out our Rad-Hard and heterogeneous integration capabilities. Both programs are expected to be long-term growth drivers, but our near-term headwind on profitability.

In the fourth quarter of 2021, depreciation related to the Rad-Hard program was $1.7 million and we incurred $2.7 million in cost of revenue for Florida. In 2021, these investments in Rad-Hard and heterogeneous integration were $14.5 million combined of our cost of revenue. GAAP R&D in the fourth quarter was $1.2 million, compared to $1.7 million in the fourth quarter 2020. Adjusting for equity based compensation, non-GAAP R&D was $1.9 million in the fourth quarter 2021 versus $1.6 million in the prior year's fourth quarter.

GAAP SG&A was $10 million compared to $6.7 million in the fourth quarter last year. The increase was driven primarily by public company cost and stock-based compensation. Non-GAAP SG&A was $8.3 million in the fourth quarter of 2021, compared to $6.2 million last year.

Adjusted EBITDA was a loss of $4.9 million declining from a positive $1.3 million last year, reflecting the decrease in gross profit flow-through this quarter. Cash used in operations during Q4 was $13.7 million. We invested $5.6 million in CapEx this quarter on fab maintenance and improvements. We ended the quarter with $12.9 million in cash and cash equivalents.

Total debt outstanding was $59.4 million as of January 2, 2022, which includes $24.8 million for our revolver and $34.9 million for our variable interest entities. Total inventory at the end of Q4 was $17.5 million, compared to $27.2 million at the end of fiscal year 2020. Q4 2021 ending inventory reflects the $13.4 million write-down of the temperature differential sensing wafers.

As you update your SkyWater models, the following is some additional color for our expected operating costs for the first quarter of 2022. Research and development expenses are anticipated in the $2 million to $2.2 million range, excluding stock-based compensation. SG&A expenses are expected to be approximately $10 million, excluding stock-based compensation. And finally, we anticipate annual stock-based compensation to be approximately $9 million.

With that, I'll turn the call back to Heather and welcome your questions on SkyWater.

Heather Davis

Senior Director-Investor Relations & FP&A, Skywater Technology, Inc.

Thank you, Steve. SkyWater will be participating at the SIG Technology Conference on March 4. Please visit the Investor Relations section of our website for other upcoming presentations. Operator, please open the line for questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first question from Krish Sankar with Cowen and Company.

Krish Sankar
Analyst, Cowen & Co. LLC

Q

Question is, you're guiding to 25% of total revenue growth this year. How should we think about Wafer Service and ATS growth relative to that 25% compared to last year? And can you say how much of this year's revenue growth is driven by volume versus pricing dynamics?

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeas. So good question. The way I would think of it is that Wafer Services obviously continues to increase our activity level. We have been driving a lot of productivity improvements and hiring in the fab to continue to not only produce more volume from our legacy programs, but also ramp the programs, including power and some of the others that transitioned out of ATS into Wafer Services this past year. So I continue to believe that Wafer Services will become an increasingly large component of the overall revenue stream.

But that said, we did grow our customer base by 70% last year. We have a lot of new ATS programs that began ramping last year and will continue to ramp this year. And we expect ATS to also grow at a very healthy pace as year unfolds. So it's really going to be that combination of both that will drive the revenue for this coming year.

Steve, you've got anything to add?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

No. That's a good answer.

Krish Sankar
Analyst, Cowen & Co. LLC

Q

Got it. That's really helpful [ph] comments (19:22). As a quick follow-up. I understand demand is strong. But how should we think about seasonality in the current Q1? And have you – did you guys give any color on how to think about CapEx for the full year? Thank you.

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

On the seasonality, I would say that we really don't see too much in terms of seasonality. Obviously, we do have some government programs that can be somewhat cyclical in terms of when timing occurs. And then in the automotive sector, we tend to see a little bit of cyclicality there. But for the most part, I think we're somewhat immune to those dynamics that say you would see in more of the consumer markets.

For us, it's all about execution, frankly. We have a very strong portfolio of programs that customers are very eager to move not only through our ATS funnel, but ultimately to value manufacturing. And I think this drive for more –

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electronics is just really accelerating the adoption of our model. So we feel really good that we are somewhat immune to may be some of the traditional seasonality effects that have plagued our industry for many years.

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

The only that I might add on to that would be, remember, in Q1 of 2020, we also had approximately $15 million of tool revenue that came through. So remember, that was a pretty unique opportunity for us. We were thankful for that opportunity. We hope to get some gains off of that in 2022, but we don't expect that to be repeatable in Q1 of 2022.

Krish Sankar
Analyst, Cowen & Co. LLC

Q

Got it. And then I think on the CapEx side?

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah. On the CapEx side, of course, well, I think we have a targeted, we'll call it, internal R&D of what is it, Steve, $10 million this year?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

Well, on the investment side, if we look at it from an overall investment perspective. So with the numbers that were provided on the call, you can see that we are slightly increasing our R&D investment over the course of 2022. We still are looking in for targeted CapEx spend that fits within our strategy, but we also invested approximately $35 million over the course of 2021 that we were leveraging a return on starting in 2022. So, again, a lot of investments made over the course of 2021 that should start generating return in 2022.

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah, I have something to say on that. One thing that's important to understand about SkyWater is we get access to capital at a very different investment rate than some of our competitors. And we have been taking those investments, getting them put inside the fab and have been essentially making them operational over the last 12 to 18 months.

As those tools become effective in not only adding output on the Wafer Services side, but also accelerating our ATS programs, we expect to see a very nice return on invested capital for the investments that our partners make with us. So the CapEx that we make internally coupled with a lot of the investment that we make through our ATS programs really gives us kind of a strong R&D pipeline that will drive future growth in years to come.

Krish Sankar
Analyst, Cowen & Co. LLC

Q

Thanks, Tom. Thanks, Steve.

Operator: And next, we'll go to Raji Gill with Needham & Company.

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Raji Gill
Analyst, Needham & Co. LLC

Q

Yes, thanks for taking my questions. I appreciate it. I just wanted to get a sense of the $15 million of revenue that was pushed out from Q3, Q4 into this year. In the past, and you had broken it down into kind of three components. You had a power MOSFET program revenue. You had a multi-year ATS program that didn't book revenue in the quarter, but was supposed to kind of move through the stages of development.

And then lastly, you had a $3.5 million government contract, in which the funding was awarded, but it wasn't released yet. So there were kind of three components related to the $15 million push-out that had different kind of timing dynamics related to each of those.

So my first question is, if you could maybe give us an update on those three components and kind of where we are in terms of kind of recognizing that revenue. And then, Steve, you talked about the margin expansion later in the year. I was wondering if you could kind of describe that a little bit more detail. Is the margin expansion really going to come from – obviously, more volume running through the fab? Are you getting kind of a better fixed – absorption of fixed costs? Just curious how you're thinking about the margin expansion, if there's any kind of way you can provide the sense of the magnitude of the expansion? I appreciate that. Thank you.

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah. Great. Great questions. I'll start with the $15 million. So you nailed the three. There was the multi-year program. We, again, had pushed some of the milestones into 2022. That is continuing to execute per plan. The end customer as well as SkyWater and our other partners are driving this forward. And we're very confident that everything is moving forward so that we can complete the initial program scoping and move on to the next phase of that particular engagement.

In terms of the power management, as I alluded to in my remarks, we're really excited about what's happening in power. We have the A&D technology that we continue to prepare to ramp with AND and their end customer this year. And then we also have several other, I would call, more traditional power platforms that we continue to make progress on as we prepare to ramp those.

And then as we talked before, we're also strategically looking at the GaN market, that is a longer-term play for us, but we're doing a lot of exciting things, laying the foundation, so that ultimately we'll have traditional power MOSFETs, coupled with our new A&D technology, which what I would call a bridge technology to ultimately getting to GaN.

And then in terms of the government push-out, obviously, we've all heard that the government has not yet closed on the budget. The expectation is that will occur in early March, but that's kind of the gating item for getting the release of the awarded funds that we referenced in the last meeting.

And then I would like to just point out on the Wafer Services ramp. We really are making great progress in terms of the execution in the fab. We're navigating labor market challenges increases and what you have to pay to get employees inside the fab. But a lot of the things I talked about last quarter are coming to fruition. And we feel really strong that not only is the Wafer Services portion beginning to execute much better, but also the integration of ATS and Wafer Services into a holistic operating model is allowing us to accelerate the transition of customers as they move through our funnel.

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Steve, anything to add on the gross margins?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

Yeah. So to answer your question on the gross margin, that's something that we're looking at and expecting in the second half of this year. You saw the increased cost of revenue coming through in the fourth quarter with some of the constraints that we're dealing with in supply chain, the labor increases in the market. So we expect that to be remaining with us in Q1 and over the course of 2022.

However, as Tom mentioned earlier in the call, the combination of growing top line revenue in both Wafer Services and ATS, once we get to certain levels of revenue, that's really when you start to see the margins expanding. So it will be a combination of a better cost absorption on the Wafer Services side, but also the high margin business on the ATS side growing. That's what will lead to a combination of top line revenue growth that will lead to gross margin flow-through.

Raji Gill
Analyst, Needham & Co. LLC

Q

Oh, great. That's helpful to understand that. So when you're thinking about your near-term target of 25%, you're hoping to achieve that. And just a follow-up, from the previous question, does that include that $15 million number that was pushed out from Q3, Q4 into this year. Does that assume that that level of revenue will be recognized?

And then maybe you could just – if you could help me parse that out versus some of the new customer programs that you're talking about and kind of ramping through the whole process. So just – again, just curious if – when you're talking about the near 25% number, does that include your assumption that you will be able to recognize the revenue of that $15 million? And what would be above and beyond that? Thank you.

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah, I would say – oh god, sorry.

Raji Gill
Analyst, Needham & Co. LLC

Q

No, no, thank you. Go ahead.

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah, I'll start and Steve, you can amplify. The way I would think of it is, obviously, the $15 million push-out, as I just articulated, is going to continue to flow into 2022. Obviously, some of these programs, they don't go away, but the timeline shifts a little bit. But it's really going to be a combination of that plus the increased customer base, the strong pipeline, 50% increase in the size of our pipeline. Those we expect to have some conversions. We expect to see more strength coming out of our Florida operation as those programs continue to ramp.

And then, again, we have been adding a lot of capacity into the fab in our back-end of line copper [indiscernible] (29:41). We've been strategically investing and adding other capabilities. I've mentioned before, we have a new TWINSCAN from ASML that is now installed and being put into production. So all those variables combined is what give us confidence that we can maintain the long-term growth model of 25%.

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And of course, we're operating against a backdrop of a lot of excitement about this technology as a service approach that we're bringing to the industry. And that's what's really driving the growth in our customer base. And we become the sole source provider for these customers. And every one of them wants to get to market as quickly as possible. I get asked all the time, what can we do to move faster, and that's clearly one of the things that we work on every day.

Steve, anything to add?

Raji Gill
Analyst, Needham & Co. LLC

Q

I appreciate that. Thank you.

Operator: Okay. Next, we'll go to Natalia Winkler with Jefferies.

Natalia Winkler
Analyst, Jefferies LLC

Q

Hi, guys. Thank you so much for taking my question. So I guess one of the questions that I wanted to address. Steve, you just mentioned that there's some kind of level of revenue where you guys would have better fixed cost absorption. So I'm just curious if you could possibly share with us some more color on this. And how should we think about it?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

Yeah. Clearly, the financials that we've seen on the revenue side coming through, we're showing a negative gross margin for – on a quarterly basis over the course of 2021. Now remember within that, we are making significant investments for the Rad-Hard technology and the heterogeneous integration in our SkyWater Florida location as well.

But with that, with the cost coming through, we need to be at a level that would be in the mid-40s for revenue for one that really has started generating some positive gross margin for the organization while continuing to invest for the long-term growth of the company.

Natalia Winkler
Analyst, Jefferies LLC

Q

Understood. That's very helpful. Thank you. And then if I may, just two follow-ups. So one is on the GaN program, would you guys mind sharing kind of a little bit more on your progress? And I guess when we think about that CapEx program that you've announced, the $56 million. Can you share with us like how far are you through that program? Is there a lot left in it, or has the bulk of that being spent in 2021?

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah. So as Steve said, we did invest $35 million in CapEx last year. We got strategic approval from the board to do targeted investments. We have others that we're continuing to evaluate in terms of again driving Wafer Services and ATS program acceleration. The GaN component of it, again, as I just alluded to, is very strategic for us. We're looking at both the technology side as well as the – putting the manufacturing capability in place. We have active discussions going on with multiple technology partners and end customers.

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And again, we're linking this to our overall GaN strategy – I mean, our overall power strategy with GaN being kind of the final component, as I alluded to, with power MOSFETs, traditional power MOSFETs today leading to the A&D technology that we'll be introducing this year. Again, kind of a bridge technology allows us to attack a portion of the market that you can't with traditional silicon and also do it in a much more cost competitive way than you can with GaN. But ultimately, GaN, we see being a player that will have more color around as this year unfolds.

Natalia Winkler
Analyst, Jefferies LLC
Q

Understood. Thank you. And sorry, my last follow-up is just on the labor cost. So I think, Tom, you mentioned that you guys increased the labor force by 70% versus 2020? And just curious if you can give a little bit more color on how does that [ph] level (33:46) increase allocate to whether it's the existing footprint or maybe you have to extend the Florida facility or the Rad-Hard packaging facility in Minnesota?

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.
A

Yeah. So just to be clear, the customer increased by 70% since our IPO. We have, as that said, hired a lot of new personnel in the company. The cost of labor is the real driver that we've been dealing with, 50% of the COGS increase for the last quarter, beyond the prior quarter was driven by the cost of labor. So it's just requiring more dollars to get people to work in places like SkyWater. It's a very competitive market.

And so we've had to put in some changes in terms of our salary structure, especially within the fab so that we can create good sticky relationships with our employees. So I would say that is going well. The ability for us to make those employees effective is something that we're also very focused on. A lot of exciting things that we've been doing in the company to not only hire people, but get them to a high level of productivity as quickly as possible.

Steve, anything to add?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.
A

Excuse me. Just to reiterate, the 70% was talking about the customer count increasing, that was not referring to head count or labor spend increases.

Natalia Winkler
Analyst, Jefferies LLC
Q

Yeah. Sorry, it was 50%. Thank you. Thanks a lot.

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.
A

No problem. No problem.

Operator: Okay. Next, we'll go to Harsh Kumar with Piper Sandler.

Harsh V. Kumar
Analyst, Piper Sandler & Co.
Q

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Yeah. Hey, guys. Thanks for hosting this call. I had a couple of questions. One question we're getting from a lot of investors is just the confidence level in the 25% growth rate that you're citing for 2022. Could you maybe – I don't expect to go through the details. Could you maybe give us some color on how confident you feel about achieving that sort of a growth rate? And one of the earlier questions was trying to get at the component of growth, ATS versus Wafer. Maybe you could just highlight for us which one you think will be the bigger portion of that 25% growth.

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah. So, again, I think what gives me confidence is what I keep reiterating. And it's something that I think is somewhat unique is that we are bringing in a lot of new customers. There's a lot of interest in the types of capabilities that we're bringing to the market. I think our model is very different than the traditional foundry approach.

We're working with a lot of customers who like the common – I'll call it the combinatorial effect of being able to take MEMS technology, CMOS technologies, other things that we do and combine them into solutions through heterogeneous integration platforms. These are all things that make us feel very confident that we're building the customer base. We have a unique model. We are improving the execution of ATS and Wafer Services in the fab.

And of course, we have several exciting programs. I mentioned the Rad-Hard program that we expect to move to productization later this year. And so all those factors are coming together, and that's what makes us – make statements like we feel like we can continue to grow with the long-term model of the 25% that we alluded to.

The other thing is that we really do feel like the dynamic and a lot of the activity that's been going on around the US government investing in semiconductor manufacturing, the excitement that we see at the state level, will also continue to drive the industry forward. And we fully expect to take advantage of that. So, it's really that combination.

And then related to ATS versus Wafer Services, ATS is the engine of growth for our company right now because that is the thing that is filling our pipeline with a lot of new differentiated technologies. So we certainly expect to continue to see growth there. But as those programs move through the funnel into Wafer Services, you're going to expect to see Wafer Services grow as well. So it's really going to be that combination. And as you get beyond 2022 into 2023, you'll see more and more growth in Wafer Services as those programs progress. But as we've said before, we also have a backlog where we want to bring new customers through the funnel. So overall, you'll see growth in both areas.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Got it. Thank you. And then for my follow up, there was a large ATS customer that was – I guess, the contract was to be renewed or even expanded possibly pending some qualifications. I was curious if you could talk about the status of that customer to the extent that that is possible publicly?

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah. I would just say that we expect that customer to begin to engage with us this quarter. That's about all we can say. Again, the – don't think of it as just immediate replacement, the customer is coming back. We're working

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on a longer-term commitment from them, but we are definitely in dialogue with that customer and expect to start generating ATS revenue again far then this quarter.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Oh, so you will start to generate revenues to them – from them this quarter. Tom, is that how I should look at it?

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah. But, again, don't assume that it will be at the rate that it left off last quarter, I think, or last year. So they will be starting up again. It's being reconfigured, again, around a longer kind of timeline, but that customer is actively engaged with us. And we expect to start doing work for them before this quarter is out.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

No, that's great. That's a start. And then on gross margins, Steve, maybe I had one for you. Again, a lot of the investors that we have in your stock are longer-term guys. They kind of want to see profitability at some point in time. I think correct me if I'm wrong. I mean in a previous answer, you alluded that maybe breakeven is possible in the mid-40s. Is that how I should take it with the new cost structure? Or am I missing something here?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

No, that's a pretty good estimate, especially given what I'll call the new cost structure that includes investments we're making for the long-term. So as I mentioned in the comments, we were at about $2.7 million in Q4 in our advanced packaging facility in Florida, right? So that's an annual run rate.

We still are trying to monitor our spend to keep spend down or invested wisely. But as Tom alluded to as well, we're also going after a trusted certification in different facilities, so there's some additional cost and investment that needs to be made. But I think we can be very close to that breakeven with our new cost structure in the near term that if we execute on the opportunities that are before us, it could come through in the second half of 2022.

Now remember, the investments that we're making in RH90 in Florida, pretty good investments in Florida alone. We now have access to $133 million of building and equipment. And if we invest around $12 million for that, that's a pretty good return for the long term on that investment.

Harsh V. Kumar
Analyst, Piper Sandler & Co.

Q

Understood. Thanks, guys. That's it for me. Thank you.

Operator: And we do have a follow-up from Raji Gill of Needham & Company. Your line is open.

Raji Gill
Analyst, Needham & Co. LLC

Q

Thanks for the follow-up. And sorry to beat a dead horse, but I just wanted to get some – a little more clarity on the 25% growth rate or near 25% growth rate this year. So as you know, in 2021, you had about $19 million of tool revenue. So I'm assuming that's not going to kind of repeat itself this year in 2022. So there's a potential –

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there's a $19 million headwind. And if you strip that out, it would imply a much higher growth rate in ATS. And so I'm assuming of that you'll be able to offset that $19 million, perhaps with the $15 million that is being pushed out, but then you would need at least another $25 million or so of additional business to get to kind of close to that 25% number.

So just number one, are you expecting any tool revenue this year? I know it is a lumpy business. And number two, if you're not, maybe you can kind of walk us through a little bit, if you can, how you kind of intend to offset that $19 million headwind that was embedded in the 2021 revenue. Thank you.

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

Yes, I can talk first about the tool revenue and then Tom can talk about the revenue growth. But on the tool side, we don't expect the same levels of tool revenue in 2022 that we had in 2021, especially a quarter with $15 million of tool revenue like we saw in the first quarter of 2021. As far as the revenue growth, Tom, can you talk about the plan for that?

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

A

Yeah, I mean, it literally goes back to what we've been saying. There's a lot of activities that we are continuing to ramp in the ATS side of the business. We are moving, again, the power of MOSFET and power solutions to volume that was not in the plan last year. So we – some of that did get pushed out as related to A&D. But the idea is that we have new business coming into Wafer Services, the ATS transitions, plus continued strong demand from our existing Wafer Services customers. And we have a very strong set of new customers that want to move very quickly on the ATS side.

So the strength in our customer base, the strength of their appetite to move quickly and the ability for the fab here in Minnesota as well as in Florida to execute to absorb those customers and move them through their cycles of learning, ultimately leading to volume production is what gives us confidence in the 25% targeted growth rate.

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

And just to add on to that, I think it goes back to Tom's previous answer on a similar question a while ago, we have opportunity for balanced growth across ATS and Wafer Services over the course of 2022.

Raji Gill
Analyst, Needham & Co. LLC

Q

Got it. Thank you.

Operator: And there are no further questions at this time. I'll now turn the call back over to Tom Sonderman for any additional or closing remarks.

Thomas Sonderman
President, Chief Executive Officer & Director, Skywater Technology, Inc.

Thank you. As I look at where we are today, compared to five years ago at our company's inception, it is my strong conviction that with the technology achievements we are making on a routine basis and the customer wins that we continue to capture, SkyWater has never been better positioned to achieve our financial objectives and

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play our role in the ongoing renaissance in semiconductor manufacturing in the United States. Thank you for your interest in SkyWater.

Operator: And this concludes today's conference call. You may now disconnect.

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