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Skywater Technology, Inc. (SKYT)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the SkyWater Technology First Quarter 2022 Financial Results Conference Call. 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.

Claire McAdams, Investor Relations with SkyWater, you may begin.

Claire E. McAdams

Founder & Managing Partner, Headgate Partners LLC

Good afternoon, and welcome to SkyWater's first quarter fiscal 2022 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 conclude.

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 today and our fiscal 2021 10-K filed on March 10. All forward-looking statements are made as of today, and we assume no obligation to update any such statement.

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 otherwise noted, all comparable periods referenced today are versus the prior year or the first quarter of fiscal 2021.

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With that, I'll turn the call over to Tom.

Thomas Sonderman

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

Thank you, Claire, and good afternoon to everyone on the call. Today, we are pleased to report total Q1 sales of $48 million. While GAAP reported revenues were essentially flat year-over-year, total revenues, excluding tool sales, were up 44%. This reflects Advanced Technology program sales or ATS growth of 13% and 115% growth in Wafer Services. This was higher than forecasted for Q1 due to the completion of our new contract with Infineon, which is our largest historical customer, and the associated impact on our GAAP results.

Per the 8-K filed at the end of the quarter, the revised contract terms reflect a significant price increase, as well as a change in revenue recognition, with Wafer revenues being recognized over time instead of when shipped. This resulted in immediate revenue recognition of all work-in-process wafer inventory within the quarter and all at the higher price level.

The result was Q1 revenue upside of approximately $8 million, which was more than offset by higher costs attributed to this WIP inventory, resulting in a slightly negative reported gross margin for the quarter. With improving pricing and volume momentum, our non-GAAP gross margin was positive and would have been even higher without this impact. While the incoming impact resulted in significant upside in our Q1 revenues, our prior growth forecast for the full year had already reflected our expectations for better pricing and the recognition of all WIP revenue in Q1 is effectively a pull-in of expected finished wafer sales from the next couple of quarters. Importantly, the new contract recognizes the value SkyWater is bringing to the market and is a key element of our strategy to drive permanent pricing expansion. It also means that our overall business is being valued at a higher level than it was previously. Our legacy technology and products continue to have value and a growth path in the market, which gives us confidence in our base of business moving ahead as we seek to diversify and grow our customer portfolio.

To that end, we continue to work toward securing long-term agreements across all market verticals as we create an increasingly robust sales pipeline. In fact, as we enter the second quarter, we see the mid $40 million range as a new baseline revenue level, which means we have effectively reset or recalibrated our revenue level at these outputs.

We have also raised the revenue baseline from which to grow as we look to the second half of 2022 and beyond. After adjusting for the pull-in of revenue into Q1, we expect to deliver on sequential improvements in revenue output throughout the forthcoming quarters. As a result, our confidence has increased that we can achieve revenue growth in 2022 near our long-term annual growth target of 25%. Further, the pay-as-you-go model, with revenues being recognized over time, will result in more visibility and less volatility in our quarterly results.

In Q1, we continued to win new business, signing three new ATS programs and three new Wafer Services customers. Importantly, for our long-term model, our results and expectations are consistent with our prior target of achieving positive gross margins at the mid $40 million revenue level. Key to our gross margin expansion plans and therefore our earnings growth story is that we expect to grow revenues from this baseline without incurring the same level of additional costs given the fixed cost nature of our business.

Non-GAAP gross margin was a positive 1.1% compared to 11.5% in Q1 of last year and negative 6.1% in Q4 of 2021. To aid in the comparability of our quarterly results, our non-GAAP gross margin adjusts for equity-based compensation, which was immaterial before the IPO, as well as the impact of unusual or episodic items such as

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the inventory write-off in Q4 and tool sales, which typically is pass-through revenue, but unique to Q1 of last year, was highly profitable. We are pleased with the progress made in Q1 to show sequential improvement and return to positive gross margins. The lower margin compared to the same period last year primarily reflects the negative margin on the WIP inventory pull-in, as well as the additional wage and hiring costs associated with manufacturing labor, higher costs associated with managing through the industry supply chain constraints, and increased investments in our strategic platforms.

As demand for our technology-as-a-service model increases, we have continued to hire at our fabs to support increased activities. In late April, Fed Chairman Jerome Powell described the job market as extremely tight and unsustainably hot, with wages rising at their fastest pace in decades. Manufacturing labor turnover continues to be a headwind to profitability. The supply chain for substrates, equipments, chemicals and gases remains congested with rising prices. Freight costs, especially, are increasing above the already elevated rates we witnessed in Q4.

We have been able to resolve multiple supply chain issues by dual sourcing gas supplies and qualifying new vendors. We have resolved the supply of neon, helium, nitrogen and hydrogen, but prices are elevated. While a small part of our overall material costs, in the case of neon prices are up 13x, we are watching the market closely as other materials become issues to resolve.

Gases, chemicals, parts, wages, hiring and other areas seeing price inflation will continue to be a focus. 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. Adjusted EBITDA was a negative $4.8 million in the first quarter.

Now, I will provide an update on our four strategic growth areas, starting with bio-health. Last quarter, we discussed our exciting partnership with Rockley Photonics. Continuing their momentum, in Q1, they entered a development partnership with Medtronic to expand their biomarker sensing platform for wearable devices in the inpatient care market.

Rockley is engaged with multiple wearable and medical device customers and continues to announce new products. Importantly, for SkyWater, our Rockley revenues grew sequentially in Q1 as we progress through our manufacturing readiness level or MRL process, as we move towards volume production later in 2022. This is an exciting program for our company and that is ramping in both Minnesota and our Florida location.

Our other bio-health programs continue to progress in manufacturing readiness, as several significant design milestones were completed in the quarter on the path towards upcoming regulatory approvals needed for production ramps anticipated to initiate later this year. In our mixed-signal and power management category, SkyWater and Infineon have fully executed new volume manufacturing agreements extending our existing engagement for mixed-signal ASIC production. As I noted earlier, these include an adjustment to current market pricing on core and legacy platforms as well as more favorable manufacturing commitments through a new non-cancelable order structure.

Improved pricing on legacy business is an important milestone, but we continue to focus our efforts in strategic growth areas that are accretive to gross margin. Our customer and technology partner, Applied Novel Devices or AND presented their breakthrough MOSFET technology at the annual APEC conference in Houston in March. The technology has been recognized by numerous product design groups since that time for its GaN-like performance and ideal characteristics for enabling efficient power conversion. We see growing engagement in several application areas for this technology as we march towards our production ramp this fall.

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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, fan-out wafer-level packaging and wafer bonding. Additionally, our Florida fab continues to progress towards production readiness as indicated by the completion of our ISO 9001 qualification in the first quarter.

Last quarter, we reported on the first silicon milestone for our DOD-funded IBAS silicon interposer program. This continues to progress ahead of schedule. Phase one qualification lots are in line and expected to come out in the coming weeks, which will be a major milestone enabling further customer engagement based on our qualified test vehicle demonstration.

Subsequent program milestones will focus on qualifying TSVs and incorporating backside redistribution layers and passive circuit devices, which will enhance our capabilities for more sophisticated multi-chip module and high-frequency solutions.

We also initiated a project to fabricate Deca Technologies' M-series test vehicles, which are a key aspect of our market and customer development efforts. The test vehicles will represent a basic architecture that leverages Deca's disruptive, adaptive patterning technology and is a key enabler for achieving state-of-the-art fine pitch for fan-out wafer-level packaging integrations. The current project plan is for the test vehicle data package to be completed and available for customers later this year.

SkyWater is continuing to advance our capabilities in wafer-to-wafer bonding technology through a partnership with a major equipment vendor. We are currently on schedule to complete our production wafer-to-wafer bonding tool qualification in Q2 and begin supporting customer applications. We view this as a critical pillar of our heterogeneous integration technology platform and a key building block that will enable our customers to develop secure state-of-the-art 2.5D and 3D technology solutions.

Rad-hard progress throughout Q1 set the conditions for the conclusion of the development phase at the beginning of Q2, with the highly anticipated award for the production and qualification phase beginning in Q3. We continue to expect rad-hard revenues to begin to ramp as 2022 unfolds. This includes additional follow-on activities that will bridge the gap between the phases as we work with our industry partners to build our rad-hard ecosystem, including the creation of a specific rad-hard IP library and additional open source-enabled design enablement solutions.

One major benefit we expect to realize as we move our rad-hard platform from development to production is the ability to leverage the state-of-the-art capability in the commercial markets, specifically those requiring radiation-tolerant capabilities which are not as stringent as our government-sponsored programs. Our LEO, our Low-Earth Orbit strategy, will be focused on civil and commercial space opportunities over the coming months. This is a notable example of how we will leverage our strategic rad-hard investments and manufacturing capacity to deliver high-margin products into the commercial space.

Also in Q1, we announced a collaboration with QuickLogic for rad-hard FPGAs, further expanding our design ecosystem for advanced extreme environment solutions. Moreover, customers producing rad-hard devices at SkyWater will benefit from our decades-long heritage of commercially focused manufacturing for demanding in-markets and high quality standards for low and high volume designs.

Finally, the continued commitment by the President, the Senate Majority Leader, the Speaker of the House and Members of the Minority Party to pass final legislation containing federal incentives has never been more

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important for our country. It is imperative, for a balanced supply chain, that the US government enact this critical legislation promptly.

In addition to responding to recent inquiries from the Department of Commerce on the administration of the grant program, the SkyWater team has been collaborating with its partners and the DoD to respond to their own request for information as they contemplate activities to bolster the domestic semiconductor supply chain and strengthen the defense industrial base.

As the only US-owned pure play foundry, elected officials and policymakers continue to reach out to SkyWater to better understand our technologies, the workforce development initiatives we are leading in Minnesota and Florida, and how their decisions will enable the successful reshoring of this crucial industry. In recent weeks, we have met with members of Congress from Minnesota, Florida and Texas, as well as the Governor of Michigan, to discuss how we can rebuild America's leadership in advanced manufacturing.

To summarize, our 25% growth objective incorporates three elements of revenue appreciation: Meeting technology development milestones and achieving better pricing, transitioning more of our technology programs to volume production, and achieving greater fab efficiency. We made progress on all these fronts in Q1 and still have plenty of room for continued growth as we progress through the year. Our strategy is built around transitioning to higher value and higher margin for wafer business, not solely pure volume increases. Our Q1 activities and results demonstrate progress towards this strategy. While concerns around semiconductor industry softness are pervasive and incessant, it is important to note that the primary areas of softness, such as consumer-driven smartphone and PC demand, are not material markets for SkyWater. Our strategic growth areas such as bio-health, extreme-environment microelectronics, and superconducting, and automotive power, and IoT are continuing to see strong and growing levels of investment and excitement.

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 to fuel future growth and further our ability to co-create the technology's other future with our customers in a post-Moore's Law era. For 2022, our progress in Q1 provides increased confidence for revenue growth near our long-term goal of 25%. This is supported by continued expansion of our sales pipeline, important program design wins, and the expected progress of our bio-health, power management and radiation-hardened platforms moving beyond development towards productization. The expected revenue growth in 2022, coupled with our new baseline revenue level and improved pricing, have established positive gross margins in the mid $40 million revenue range and positions 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 Manko

Chief Financial Officer, Skywater Technology, Inc.

Thank you, Tom. Total revenue for the first quarter of 2022 was $48.1 million, which was essentially flat year-over-year and up 25% sequentially from the fourth quarter. Advanced Technology Services revenue was $26.6 million, and Wafer Services revenue was $21.5 million.

There are a couple of important adjustments to make when comparing our revenue performance to prior periods. First, ATS revenue in the first quarter of 2022 included just $1 million of tool revenue compared to an unusually high $15.4 million of tool revenue in the first quarter of 2021. Second, Wafer Services revenue in the first quarter of 2022 included the pull-in of $8.2 million of revenue related to the new frame agreement with Infineon. This form

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of revenue is due to an accounting adjustment in the first quarter related to the now non-cancelable nature of purchase orders from this customer. Effective April 1 of this year, SkyWater recognizes revenue over time as the wafers were being fabricated. Prior to April 1, SkyWater was recognizing Wafer Services revenue for this customer at a point in time, such as when the wafers were shipped. Given the April 1 effective date, which was before our fiscal quarter end of April 3, this necessitated a one-time accounting adjustment to recognize overtime revenue for the Infineon-related work-in-process or work inventory.

Excluding the WIP revenue adjustment, which was an acceleration of revenue from future quarters and at higher prices, Wafer Services revenue would have been $13.2 million, up 33% year-over-year on a comparable basis. Excluding tool revenues, ATS revenue of $25.6 million was up 13% year-over-year. Increased revenue in both ATS and Wafer Services continues to track well against our revenue growth targets for 2022 as we continue to ramp production and win new customers and programs. GAAP cost of revenue was $49.1 million, an increase of 26% year-over-year. Non-GAAP cost of revenue, which adjusts for cost of tool sales, equity-based compensation, and for the startup costs, as well as the inventory write-down, was $46.6 million in the first quarter of 2022, up 61% from $28.9 million in the first quarter of 2021. So, while GAAP gross loss was $0.9 million for a negative 2% gross margin, non-GAAP gross profit in the quarter turned positive at $0.5 million for a non-GAAP gross margin of 1.1%.

While we are pleased with our progress returning to positive gross margins, our ongoing costs of revenue continued to be impacted by increased costs associated with both labor and supply chain constraints, as well as our investments for long-term growth. We continue to make investments for long-term growth of the company by building out our rad-hard capabilities in Minnesota and heterogeneous integration capabilities in Florida. Both programs are expected to be long-term growth drivers, but are near-term headwinds to profitability.

In the first quarter of 2022, depreciation related to the rad-hard program was $1.5 million, and we incurred $2.8 million in cost of revenue for Florida when excluding tool costs. This compares to a combined $4.4 million in the prior quarter and $1.7 million in the first quarter of 2021. Despite these increases, our first quarter gross margin improvement compared to fourth quarter 2021 is consistent with our prior expectations for a return to gross profitability at the mid $40 million range for quarterly revenues.

Further, we expect stronger gross profit flow-through off of this baseline as we progress through the forthcoming quarters and years. GAAP R&D for the first quarter was $2.3 million compared to $1.9 million in the first quarter of 2021. Non-GAAP R&D was $2 million in the first quarter of 2022 compared to $1.9 million in the prior year's first quarter. GAAP SG&A was $11.6 million compared to $8.6 million in the first quarter last year. The increase was driven primarily by public company costs and stock-based compensation. Non-GAAP SG&A was $9.7 million in the first quarter of 2022 compared to $8.2 million last year.

Adjusted EBITDA was a loss of $4.8 million, declining from a positive $5.6 million in the first quarter of last year and flat with the fourth quarter of last year, reflecting the increased cost of revenue and the negative gross margin on Infineon WIP recognized in the first quarter of 2021 revenue. Cash used in operations during Q1 was $10.7 million. We invested $4.4 million in CapEx this quarter on fab maintenance and improvements. We ended the quarter with $6.4 million in cash and cash equivalents.

Total debt outstanding was $69 million as of April 3, 2022, which includes $34 million for our revolver and $35 million for our variable interest entities, excluding unamortized debt issuance costs. Total inventory at the end of Q1 was $13.1 million compared to $17.5 million at year-end 2021. Q1 2022 ending inventory reflects the $11 million adjustment for Infineon, offset by increased inventory purchases in support of anticipated revenue growth.

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As you update your SkyWater models, the following is some additional color for expected operating costs for the remainder of fiscal 2022. Quarterly research and development expenses are anticipated in the $2.1 million to $2.4 million range, excluding stock-based compensation. Quarterly SG&A expenses are expected to be approximately $10 million to $10.4 million, excluding stock-based compensation. And finally, we anticipate annual stock-based compensation to be approximately $9.1 million to $9.4 million for fiscal 2022.

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

Claire E. McAdams

Founder & Managing Partner, Headgate Partners LLC

Thank you, Steve. Our upcoming investor activities include the Oppenheimer Virtual Emerging Growth Conference on May 10, the Cowen Technology Conference in New York on June 2 and the CEO Summit in San Francisco on July 13. Please visit the Investor Relations section of our website for other upcoming presentations.

Operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Raji Gill with Needham & Company. Your line is open.

Rajvindra Gill

Analyst, Needham & Co. LLC

Q

Yes. Thank you. And congrats on the progress, on the gross margins turning positive on a non-GAAP basis, that's really good to see as well as the good progress on the design programs. So, just a follow-up on the Wafer revenue and the $8.2 million revenue that was pulled in from the new agreement with Infineon. So, it really seems like this is a combination of a new accounting revenue recognition policy to recognize the revenue over time in the current quarter as well as higher ASPs related to the contract.

So, when we look at then the Wafer revenue going forward, how do we think about that type of revenue on kind of on a quarterly basis? If we take out the $8 million, the Wafer revenue was about $13 million. So, we'd be expecting kind of sequential growth of that base of revenue? Just want to get some clarity there. Thank you.

Steve Manko

Chief Financial Officer, Skywater Technology, Inc.

A

Hey, good afternoon. It's Steve Manko here. And great question on that. I really want to make sure everyone understands what happened there. Your understanding of the information is actually correct. What happened was it was a combination of the timing of when the quarter ended. This contract went into place and we kind of got the benefit of having some wafer shipping and also recognizing the upfront revenue for the wafers that were in process.

So as you're looking at it for the second quarter, I think you're looking at it in the appropriate fashion, looking at our Q1 Wafer Services revenue, backing out the $8.2 million which was the one-time pull-in and basing growth for second quarter and beyond off of that baseline of about $13.2 million or $13.3 million. Obviously, going forward,

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off of that amount, we would expect some increases from improved efficiency as well as the enhanced price that was built to the contract as well.

Rajvindra Gill
Analyst, Needham & Co. LLC

Q

Got it. That's helpful. And then, in terms of the gross margins kind of inflecting positive on a non-GAAP basis, when you exclude the tool revenue and then the DSO, et cetera, you mentioned that at mid-40s, you'll be able to have a positive gross margin. As we kind of go throughout the year, what do you think is going to be the biggest driver to kind of gross profit fall-through? Is it going to be continuation and just more wafer volume, better mix? So, just if you could walk me through some of the drivers of gross profit fall-through as you progress hopefully off this base of gross profit.

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

A

Yeah. I think one thing to keep in mind is that we had a higher mix of Wafers Services this quarter because of the new pricing as well as the adjustment. As we get into the out quarters starting in Q2, you're going to see more of the traditional mix of two-third, one-third, two thirds being ATS. And obviously that will drive higher gross margins. And then the other efficiencies that we'll get once we break through the mid-40s and again, more flow-through of the revenue to the bottom line.

Rajvindra Gill
Analyst, Needham & Co. LLC

Q

Thank you.

Operator: Our next question is from Mark Lipacis with Jefferies. Your line is open.

Mark Lipacis
Analyst, Jefferies LLC

Q

Hi. Thanks for taking my question. A follow-up on the revenue recognition for Wafer Services. So, Steve, are all the Wafer Services revenues now put into this bucket of non-cancelable and therefore recognizable as you generate the WIP or is that – or is this just portions of that business that fall into that bucket?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

Yeah. Great question. It would only be a portion of our Wafer Services revenue. Really, what we could look at is – if you look at the balance sheet, given the fact that we really have inventory still reflect on the balance sheet, that's an indication that we are still recognizing revenue for the non-Infineon-related wafers at a point in time. So, it's really just related to this specific contract for these wafers with Infineon. It's something we've been working for, not only to get to market pricing on that product, but also gives us better visibility, obviously negotiating for non-cancelable features for those POs coming in is really a good step forward on our direction for the near-term growth of the company.

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

A

And it is for all the Infineon products that we make.

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Mark Lipacis
Analyst, Jefferies LLC

Q

I'm sorry. Tom. Could you say that again?

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

A

Yeah. It is for all the Infineon products that we make.

Mark Lipacis
Analyst, Jefferies LLC

Q

Got it. Okay. So, I mean, it seems to me that any product that comes out of ATS that would migrate to Wafer Services, those would be like highly customized wafers that might also be considered not fungible or not cancelable. So, I'm wondering if that is – if this is a feature that you have with Infineon, that you started with Infineon, that you'd expect to kind of put to the rest of your programs that run through Wafer Services?

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

A

Yeah, absolutely correct, Mark. So, remember, going back to our take or pay with Cypress, we were basically getting paid when the wafers shipped, and then we had a period of around 18 months between when the take or pay ended, and this new contract which remained in that fashion. The model for SkyWater going forward as clearly the pay-as-you-go approach, which is applied to not only Wafer Services but also a lot of our new contracts for ATS.

Mark Lipacis
Analyst, Jefferies LLC

Q

Got you. Okay. That's helpful. And Steve, another one on the accounting mechanics. So, the Wafer Services were up $7 million. The deferred revenues were up $2.5 million. So, is that the accounting mechanics? So, does that imply that you actually shipped $4.5 million of that WIP that you recognized as revenues? Or is there a different way to think about the accounting mechanics around that – those wafers?

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

A

Yeah. That's right. So, really the WIP, the $8.2 million, really what that means at that point in time when we closed our books on April 3, none of that $8.2 million was shipped at that point in time. That would just be WIP that is in various...

Mark Lipacis
Analyst, Jefferies LLC

Q

Okay.

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

A

...stages of process in the fab. The way I think about it is, now it gives us some flexibility that I can take one wafer and move that one step where I can also take five wafers and – sorry – one wafer and move it five steps or five wafers and move it one step, I kind of get the same revenue recognition. So, it gives me better visibility and better

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flexibility on how I optimize the mix of my fab and prioritize my time in the fab on moving ATS and Wafer Services programs throughout.

Mark Lipacis
Analyst, Jefferies LLC

Q

Okay. Got you. All right. And then, Tom, a last question for you. So, you expressed optimism about the rad-hard ramp this year, and then also you mentioned power products and heterogeneous products. So, is the rad-hard ramp this year, is that going to be production – kind of solutions that you're delivering to your customers that are going into their production systems or is this like the testing phase still? And when would you expect to see power products and heterogeneous products hit your topline? And that's all. Thank you.

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

A

Great. Great question, Mark. So, on rad-hard, what we are doing is we've completed the development phase and are going into productization and qualification. So, we expect revenue to ramp. These won't be product wafers driving revenue, but program revenues as we move through the qualification sequence that our customers will be putting the devices through as they go through their own qualifications into the final systems. So, we're moving to what's considered the next phase in these government-funded programs. It's a very important phase because the next round of investment is setting the stage for our actual products that are being put in systems, which will be occurring as we exit the 2023 timeframe and go into 2024. And again, there are some programs that are replacement parts. They have a longer qualification cycle. We do have some designs that we're anticipating to go into this platform that would actually be qualified earlier. So, the whole point of the next phase is to prepare for our product shipment of wafers. And it's an important, again, milestone because the government is further investing in the program to prepare for production.

As far as power, we continue to see great traction with this platform, the AND platform, in the market. We have samples going out to the OEMs. They're beginning to go through their own qualification processes. We do have a lead customer that's driving that, and we anticipate to start ramping that in the second half of this year. And then in heterogeneous integration, a lot of that is still in the ATS side of the equation. We're making good progress on all three fronts. The IBAS program is again a DoD-funded initiative and that is moving ahead of schedule. The Deca program is for wafer fan-out packaging. They will be doing test chips that will go out to customers in the second half of this year. And then, as mentioned, we're also working with Rockley on their platform, which includes not only the wafer fabrication we're doing up here, but also some additional processing down in Florida. That's the one that has the quickest potential to go to our Wafer Services revenue as we prepare to ramp that program based on their schedules.

And then, finally, the wafer bonding technology, that's definitely still in the development phase. But we do have a lead target customer that we'll be talking more about as the year unfolds that will drive that program again through ATS. And then as we get into the early part of next year, we'll start seeing Wafer Services revenue for that as well.

Mark Lipacis
Analyst, Jefferies LLC

Q

Got it. Very helpful. Thank you.

Operator: [Operator Instructions] Our next question is from Krish Sankar with Cowen. Your line is open.

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Krish Sankar
Analyst, Cowen & Co. LLC

Q

Yeah. Hi. Thanks for taking my question and congrats on – nice to see a positive gross margin for a change. I just had a couple of questions, just to clarify. Tom, you mentioned you expect sequential revenue growth as the quarters progress this year. Was that off the baseline of $48 million in loss or was it off of $40 million backing out the $8.2 million from Infineon pull-in?

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

A

Yeah, it's definitely in the latter. So, what we continue to do is drive growth in our ATS business. And, of course, we did pull in because we had to recognize all the WIP. There was a pull-in of some of the revenue that would have materialized in Q2, Q3. That's why we're targeting somewhere in the mid-40s, is what we're anticipating. So, when you pull that out, there will be sequential growth, but it won't be off the $48 million base.

Krish Sankar
Analyst, Cowen & Co. LLC

Q

Got it. Got it. And then, the 25% growth for this year, does that still include the $15 million pushed out from last year due to government funding?

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

A

Yeah. So, make – and I want to make sure I hear that again. Say that last part again.

Krish Sankar
Analyst, Cowen & Co. LLC

Q

The 25% revenue growth for this year, does that include the $15 million that was pushed out from last year due to government funding?

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

A

Yes. Yes, it does.

Krish Sankar
Analyst, Cowen & Co. LLC

Q

Okay, cool. All right. And then one of the question I just wanted to check in is that, on the Florida fab, it seems like – you said it's progressing and then you're working on heterogeneous integration and everything. I'm just kind of curious, like you spoke about the depreciation on Florida fab, which was actually lower in the March quarter compared to the prior quarter. How should we think about it as you start ramping on this wafer-to-wafer bonding [indiscernible] (37:53) related activities? Is that depreciation going to start increasing or the CapEx related you are going to start increasing for the Florida fab?

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

Yeah. So, we talked about that. The depreciation again really relates to the rad-hard fab that we have up here in SkyWater, Minnesota. So, both elements are investments. The rad-hard is an investment; heterogeneous integration in Florida is an investment, both going through my cost of revenue. The difference being that rad-hard

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is depreciation, where the heterogeneous integration costs or more so the operating costs flowing through, so that that's not depreciation. I just want to remind you of that. But really those are at baseline levels in Florida for heterogeneous integration.

As we continue to ramp that, I would expect those costs to increase as there's more programs moving into Florida, more revenue visibility. And like we said, those programs, whether it's in Minnesota or Florida, the ATS programs start off small and ramp over time. So, as they ramp, they would mean more head count focusing on them and growing as well. So, as the revenues grow with heterogeneous integration, I would expect those expenses and cost of revenue to grow as well.

Krish Sankar
Analyst, Cowen & Co. LLC
Q

Got it. Super helpful. And then, just one last question, Steve. Can you just remind us again on the FY 2022 what you guided for R&D, SG&A and stock comp? I didn't get it completely.

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

Yeah. Let me go back to that. Copy of the script in front of me. The stock comp for the year was $9.9 million.

Krish Sankar
Analyst, Cowen & Co. LLC
Q

For FY 2022?

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

For FY 2022 for the year.

Krish Sankar
Analyst, Cowen & Co. LLC
Q

And R&D, was it $2.1 million to $2.4 million per quarter or...

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

$2.1 million to $2.4 million per quarter. I got to make sure I'm backing out the stock-based compensation from the SG&A. One second. SG&A was $10.0 million to $10.4 million for the quarter.

Krish Sankar
Analyst, Cowen & Co. LLC
Q

And that's like the way to model it over the next few quarters?

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

Yeah. That would be my expectation.

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Krish Sankar
Analyst, Cowen & Co. LLC

Q

Got it. Thank you very much. Really appreciate it.

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

No problem.

Operator: The next question is from Richard Shannon and with Craig-Hallum. Your line is open.

Richard Cutts Shannon
Analyst, Craig-Hallum Capital Group LLC

Q

Well, thanks, guys, for taking my questions. Glad to be here on the call. Congratulations, a good quarter. Just a couple questions here. I think I'll start off with the new frame agreement with Infineon. If you can characterize the level of appreciation in the ASPs and can you characterize in terms of margins here fully baked using the appreciation you have in place, is this something that's now close to 0% gross margins or it's still little bit negative here? Any way you can characterize that would be great, please.

Steve Manko
Chief Financial Officer, Skywater Technology, Inc.

A

Yeah. When we look at it from an overall perspective, we focus on activities and margin per activity. So, we really don't look at it from one individual component. Again, with what we're doing in opening up our fab for the ATS services, there's ATS programs going through that that don't allow us to run a full fab just focusing on high-volume manufacturing. So, really, what we do is we focus on how can we get each activity to be the most profitable activity in the fab. That's why, as I mentioned earlier, having us be able to recognize revenue on that activity takes the burden off of making sure we get the wafer all the way through to production in that quarter to recognize the revenue. We can only just focus on maximizing now the revenue productivity and the margin productivity.

With that now and the costs that we saw come through, pulling in [ph] $10.8 million (41:57) of cost on $8.2 million of revenue because of that, that would have a fully baked cost with all of our depreciation as it currently stands falling through. And a lot of the depreciation that goes back to the acquisition back in 2017, that will start to come off towards the end of 2013 and into the first quarter of 2014 – sorry – 2024. So, opportunities to expand our margins at that point in time. So, with that pricing and with that cost, it does have our depreciation fully baked into that, as you mentioned.

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

A

And I'll just add, we certainly went after more aggressive pricing on those legacy platforms and we achieved that. But our business is really to drive not only our ATS programs and the Wafer Services, but creating a much richer mix within Wafer Services because all those ATS programs where the single-source provider, they're all on new platforms that are just becoming products in the market. And over time, we expect the concentration of the legacy platforms to decrease.

Richard Cutts Shannon
Analyst, Craig-Hallum Capital Group LLC

Q

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Okay. Perfect. Thanks for that perspective. Question here on the growth for this year and I just want to make sure that I caught your comments accurately and I think, Tom, in your remarks about kind of a baseline in the mid-40s. And then are you characterizing the rest of the year as sequential growth for every quarter past that or could there be some variability in that?

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

A

Yeah. As I put in my remarks, I think we'll see sequential growth. We are expecting things to continue to move up and to the right as the year unfolds. There, of course, is a lumpiness to our business and we are dependent on certain government contracts coming in, so that that contingency hasn't been removed with our statements. But there clearly is a lot of positive feelings within the company and with our customer base that the programs we're working on, they're moving in the right direction. And we feel confident that the 25% targeted growth rate is achievable this year, as we've said at the beginning of the year, and continue to say, and this strong movement towards that in the first quarter increases our confidence.

Richard Cutts Shannon
Analyst, Craig-Hallum Capital Group LLC

Q

Okay. Perfect. Thanks for that confirmation. Maybe last question for me on the pipeline here. I guess it's probably more related to the ATS here, but if you could just characterize kind of the early stage part of that pipeline, where are you getting a traction here If you can characterize both by the technologies that you have in addition to the applications your customers are looking for?

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

A

Yeah. Great question, Richard. The bio-health sector and the unique capabilities we have because we have both MEMS platforms and CMOs, which allow you to kind of integrate those together in almost a Lego block fashion, is giving us a lot of traction in that space. Those programs tend to move quickly through the development cycle. So, we're seeing, I would say a faster pace on that side of the equation. And then, of course, you have power rad-hard with very extensive qualification, cycles that we're learning about as we get further into this space. And so those tend to take longer.

The whole perspective around extreme environment electronics, as it gets into the commercial space, is also something that is relatively new to us. But the pipeline conversion typically, from an initial contact with the customer to we begin working for them is between three to six months. And then as Steve has alluded to before, there's a slow ramp, the ATS programs start out with slow cycles of learning, and then as the program progresses, it picks up speed. But we have a very strong pipeline. We believe, as we continue to grow our backlog, that that confidence is part of where I get, really excited about our statement, alluding to the 25% growth because the pipeline's strong. We're building a good backlog. We have a secure partner for the higher volume portion of our business. That gives us better predictability. And we think all that really bodes well for SkyWater's future.

Richard Cutts Shannon
Analyst, Craig-Hallum Capital Group LLC

Q

Okay. Perfect. Thanks for all the details, guys. I'll jump in the line.

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

A

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Thanks, Richard.

Operator: We have no further questions at this time. I'll turn the call over to Mr. Sonderman for any closing remarks.

Thomas Sonderman

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

Thank you. As I look at where we are today compared to our company's inception, it is my strong conviction that with the technology achievements we're making on a routine basis, and the customer wins we continue to capture, that SkyWater has never been better positioned to achieve our financial objectives and play our role in the ongoing resurgence in domestic semiconductor manufacturing. Thank you again for your time. Bye.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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