

# Final Transcript

Intermolecular Inc - IMI - Earning Conference Call/Presentation- 02/13/18 05:00 PM

## Corporate Participants

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer
- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

## Conference Call Participants

- Dan Weston, WestCap Mgmt.

## Presentation

- Operator - -

Good day, ladies and gentlemen, and welcome to Intermolecular, Inc.'s Fourth Quarter and Full Year 2017 Earnings Conference Call. (Operator Instructions) Please note, this call is being recorded. My name is Andrew, and I'll be your operator for today.

I would now like to turn the call over to your host today, Mr. Bill Roeschlein, Chief Financial Officer. Sir, you may begin.

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer

Thank you, Andrew. Good afternoon, and welcome to Intermolecular's Fourth Quarter and Full Fiscal Year 2017 Earnings Conference Call. We announced our results after the market close today, and you'll find a copy of the press release on our website at [www.intermolecular.com](http://www.intermolecular.com). On the call with me today is our President and Chief Executive Officer, Chris Kramer.

Today's conference call contains forward-looking statements. Any statement that refers to expectations, projections or other characterizations of future events, including forward -- financial projections and future market conditions, is a forward-looking statement. Actual results may differ materially from those expressed in these forward-looking statements. Intermolecular assumes no obligation to update these forward-looking statements, which speak only as of today, February 13, 2018. For more information about factors that may cause actual results to differ materially from forward-looking statements, please refer to the press release we issued today as well as the risks described in our Form 10-K for fiscal year 2016 as filed with the SEC, particularly in the section titled Risk Factors.

Before we begin, please note that during this call, we will discuss non-GAAP financial measures as defined by the SEC in Regulation G. We believe non-GAAP financial measures provide useful supplemental information to both management and investors, but note that these measures are not a substitute for GAAP and should only be used to evaluate the company's results of operations in conjunction with corresponding GAAP measures. All non-GAAP measures are reconciled to the most directly comparable GAAP financial measures in our press release issued today.

Now I would like to turn the call over to Chris. Chris?

- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

Thanks, Bill. Good afternoon, everyone, and thank you for joining us on today's call.

2017 was a pivotal year in Intermolecular's development. From an operational standpoint, we refocused our resources on the growing semiconductor market, expanded into new regions like China, broadened our customer base of top semiconductor, process tool and advanced material manufacturers as well as optimized our organizational processes and cost structure. Together, these initiatives are enabling us to build a scalable, profitable and sustainable business for advanced materials innovations and services.

From a numbers standpoint, our success from these initiatives is reflected by our financial performance in the fourth quarter, during which we were able to achieve our first GAAP profitable quarter in 5 years, driven by a 22% sequential increase in revenue and a 10% decrease in operating expense.

But before I dive into further details of our operational progress and outlook for 2018, I would like to invite Bill to walk us through our financial results for the fourth quarter and full year ended December 31, 2017. Bill?

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer

Thank you, Chris. Let me review some selected financials for the fourth quarter and full fiscal year ended December 31, 2017.

Our revenue for the fourth quarter was \$10.5 million, an increase of 22% from the third quarter of 2017 and an increase of 1% from the fourth quarter of the prior year. For fiscal 2017, our revenues were \$37.2 million compared to \$47.3 million for fiscal 2016, a decrease of 21%.

Q4 '17 program revenue of \$8.8 million represented approximately 84% of total revenue with licensing and royalty revenue coming in at 16% for the quarter. Q4 '17 program revenues grew 29% sequentially as a result of an additional program from an existing memory customer as well as 3 new programs from semi ecosystem customers.

In Q4 '17, we had 3 customers which were each greater than 10% of total revenue. These 3 customers represented approximately 90% of total revenue for the fourth quarter of 2017.

I would like to remind you to please review today's earnings press release for both GAAP and non-GAAP measures and the reconciliation between those results. The key difference from GAAP to non-GAAP measures is the exclusion of stock-based compensation expense.

On this basis, GAAP and non-GAAP gross margins were 65% and 65.4%, respectively, in Q4 '17 compared with 66.7% and 67.1%, respectively, in Q3 of '17 and 67.1% and 68.1%, respectively, in the comparable year-ago period. Our gross margins declined sequentially primarily as a result of a write-off of patents associated with the Micron royalty arrangement. For Q1 of '18, we expect non-GAAP gross margins of approximately 65%.

GAAP and non-GAAP operating expenses were \$6.9 million and \$6.7 million, respectively, in Q4 '17 compared with \$7.7 million and \$7.5 million in Q3 of '17, respectively, and \$10.1 million and \$9.5

million, respectively, in the comparable year-ago period. Our lower OpEx was primarily attributable to the more efficient use of our technology team to support the uptick in our revenue-generating programs. For the remainder of 2018, we expect non-GAAP operating expenses to range between \$7.3 million and \$7.8 million as we make selective hirings to support our program revenue growth.

As Chris mentioned, we are pleased to report our first GAAP profit in 5 years as GAAP net income totaled \$0.1 million or \$0.00 per basic and diluted shares. This compares to a net loss of \$1.8 million or a loss of \$0.04 per share in the previous quarter. For fiscal 2017, our GAAP net loss was \$10.4 million or a loss of \$0.21 per share compared to a net loss of \$15.4 million or a loss of \$0.31 per share in fiscal 2016. The reduction in net loss was primarily the result of the restructuring actions taken at the end of Q1 of last year to better align our cost structures with revenues.

Non-GAAP net income for the fourth quarter was \$0.4 million or \$0.01 per basic and diluted share. This compares to a non-GAAP net loss of \$1.6 million or a loss of \$0.03 per share in the third quarter of 2017. For fiscal 2017, our non-GAAP net loss was \$8.9 million or \$0.18 per share, an improvement of 24% from our 2016 net GAAP -- non-GAAP net loss of \$11.8 million or \$0.24 per share.

Adjusted EBITDA in Q4 '17 was \$2.1 million or 20% of revenue compared to an adjusted EBITDA of \$0.1 million in Q3 of '17 and an adjusted EBITDA loss of \$0.5 million in the comparable year-ago period. For the fourth quarter of 2017, we had \$1.8 million of depreciation, amortization and accretion and \$0.3 million of stock-based compensation that were the noncash charges we netted against our GAAP net income.

As of December 31, 2017, our balance sheet included cash and investments of \$25.8 million compared with \$27.1 million in Q3 of '17 and \$27.8 million in the comparable year-ago period. The sequential decline in cash was primarily due to the growth in accounts receivable and the year-end timing of cash collections.

In summary, we're encouraged with our revenue growth and earnings and believe we are well positioned to grow the business profitably to \$40 million in revenues in 2018. Our guidance in Q1 of '18 reflects the discontinuance of \$1.25 million of Micron royalties that will be more than offset by the growth in our program services business. On this basis, we're projecting first quarter revenues in the range of \$9.6 million to \$9.9 million. Net loss is projected to be between \$1 million and \$1.3 million or \$0.02 to \$0.03 per share, and non-GAAP net loss is projected to be between \$0.7 million and \$1 million or \$0.01 to \$0.02 per share. Adjusted EBITDA is projected to range in the -- to be within the range of \$0.4 million and \$0.7 million.

And now I'd like to return the call back over to Chris. Chris?

- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

Thanks, Bill. A key reason for our growing success securing new customers is the structural changes we made to unify and optimize our organization, which have made us more cost-effective, more customer-centric. In fact, we were able to drive 30% more services business in 2017 while creating significantly more headroom and capability to scale our business further. We now have the flexibility to handle a larger and more diverse portfolio of customers and programs. Our sales and engineering teams can respond faster and more efficiently to customers' demands. It also means we can execute more effectively, manage our programs more efficiently and deliver more value for our customers.

In addition to positioning us to drive more business, these measures also optimize our cost structure. Our reorganization last year simplified our operating structure, prioritized high-growth areas and

decreased our costs. Altogether, these measures reduced our operating expenses by 24% or \$11.2 million in 2017 compared to the prior year.

Another key change we made in early 2017 was refocusing our business and resources on the semiconductor sector, a market where materials innovation for high-performance memories is particularly critical. Our customers need innovative solutions to meet the stringent specifications for their new devices. With our more than 10 years of expertise in semiconductor materials and innovation and our patented high-throughput technology platform, we're uniquely positioned to provide the materials innovation services needed to advance the industry road map.

We've expanded our business development activities to the larger semiconductor ecosystem, which includes not only the device makers but also the tool makers. Integrated device manufacturers and foundry requirements are becoming more difficult to meet, changing rapidly, and tool makers need a reliable and innovative materials partner. We believe that our highly experienced materials innovation team with more than 60 engineers and scientists can benefit materials and chemical suppliers, tool makers and microelectronics consortia alike.

As we identified on our Q1 call last May, our goal is to secure at least 2 to 3 new customer wins per quarter, which will help us to drive revenue growth and increase our visibility going forward. And I'm encouraged to report that we have either achieved or surpassed this goal every quarter in 2017, including the 3 we secured in Q4, giving us good momentum to build from during 2018. We believe this demonstrates our continued execution of securing new business and successfully meeting customer requirements.

Along that line, our pipeline of program continues to grow, not just in numbers but in diversity of customers and work performed as well. This is in line with our strategy to strengthen our position in the semiconductor ecosystem, as I just talked about, as well as focus on advanced memory market, which I will talk about shortly. In our view, a broader, higher-velocity pipeline affords us better visibility into future revenue.

Our customer momentum remains strong as we execute our strategy of expanding our leadership in emerging memories and throughout the semiconductor ecosystem. While historically our deals have focused on DRAM and non-volatile memory, we are having increasing success in emerging memories and in adjacent applications that are providing new and diverse opportunities.

Along that line, we continue to strengthen our position in the advance memory market. These next-generation memories require advanced materials innovation. Today, there's a growing need in the industry for next-generation memory technologies that can deliver the performance, density, low power and small form factors needed for the future memories and IoT devices.

Current technologies face inherent limitations in meeting these requirements, making it more important to find new materials that can solve these challenges. As some of you know, one of these types of memories is storage class memory or phase-change memory, which many believe has the potential to revolutionize the industry. However, the promise of storage class memory will not be fulfilled unless companies can solve the issues of costs, scalability, performance and scale, much like they did in 3D NAND.

In addition, semiconductor tool makers need to develop new tools and have been coming to us for our assistance. Intermolecular is a leader in using chalcogenide materials to develop PCM memories. The benefit to us is that the more types of memories there are, the more programs we can work on. This is one reason why our revenues with large memory makers is increasing.

Looking at additional growth opportunities for Intermolecular. In November, we formed a strategic

alliance with the Shanghai Industrial Research Institute (sic) [Shanghai Industrial Technology Research Institute], or SITRI it is referred to in the industry. SITRI is the innovation center for accelerating the development and commercialization of More than Moore technologies. For those of you newer to the industry, More than Moore is the next wave of innovations that do not depend on feature size-driven, CMOS technology or Moore's Law. SITRI provides Chinese entrepreneurs a full spectrum of services and resources designed to help innovators succeed in their development and commercialization phases.

As part of our partnership with SITRI, Intermolecular will extend beyond pathfinding and screening by gaining access to test vehicles and device capability through the use of SITRI's fab. Our high-throughput experimentation platform combined with SITRI's expertise and strong ecosystem can rapidly ease material screening and enable the next generation of technology innovations.

To more fully appreciate what this partnership means for Intermolecular, it's important to understand the key mandate by the Chinese government called Made in China 2025. China is moving from acquiring technologies and companies to developing technologies internally. A key reason for this is because foreign governments are blocking Chinese acquisitions. We see tremendous opportunities in the China market, but the process of selecting, testing and commercializing the right materials to deliver this can be costly and very time-consuming. As China reduces its reliance on semiconductor imports and moves towards more homegrown inventions, Chinese technology companies will intensify their R&D initiatives and rely on companies like Intermolecular to help with their materials selections, testing and evaluation.

So what does this mean for Intermolecular? Our alliance with SITRI gives us the ability and stature required to sell in China, which is a completely greenfield opportunity for us and a region where we're seeing increasingly strong demand. The partnership is off to a great start and moving at a brisk pace. We expect this partnership to drive future revenue opportunities for Intermolecular in the second half of this year and beyond. We look forward to sharing more on our progress in the coming months.

Looking ahead, our expectation -- our execution on our strategic plan in 2017 has positioned us for a growing and profitable 2018. We continue to benefit from the strong economics in the semiconductor memory market. In addition, our broader and higher-velocity pipeline is bringing in more customers who realize the benefits that Intermolecular provides. Finally, our China strategy looks very promising. For these reasons, we believe Intermolecular is well positioned for profitable growth, which is why we're guiding to \$40 million in 2018 with sustainable growth going forward.

Now I'd like to return the call to the operator for any questions. Andrew?

## Question And Answers

- Operator - -

A. (Operator Instructions) Our first question comes from Dan Weston with WestCap Mgmt.

- Operator - -

A. Yes. I guess, to start with, on the 3 new customers that you outlined, could you give us a sense of what types of programs these 3 are launching?

- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

A. I'm sorry, your last word was...

- Operator - -

A. Yes. Sorry, bad connection. Could you describe a little bit about what the 3 customer programs are involved with? Which type of memory?

- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

A. Well, what's interesting about -- for the last quarter, they weren't just all memory customers. One was a new memory application, another was an optical film opportunity and then the third was very interesting, quantum computing. And as we tried to describe in the script, this platform is broadly applicable. We're focusing on semi and the semi ecosystem, but there's a lot of unserved market there for Intermolecular that we haven't been after. Yes, we publicized, we made the [infrastructure] in memories, but we're seeing the increase and the business growing in adjacencies.

- Operator - -

A. Appreciate that. And then Bill, I wanted to ask you, just to get my maintenance down here. The Micron royalty revenue that goes away, was that \$1.25 million per quarter or total?

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer

A. It was \$1.25 million per quarter or \$5 million per year.

- Operator - -

A. Got it. When you gave your guidance of, let's call it, the \$40 million figure for '18, does that assume any more licensed deals get signed?

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer

A. No, it doesn't. It just assumes the continuation of our existing license business and continued growth in our program services business.

- Operator - -

A. Got it. And when you look at the SITRI partnership, if you will, would you anticipate that the revenue that you are able to garner from that partnership will take the form of program revenue? Or would you expect license revenue?

- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

A. I think it'll be primarily program revenue at first, but there is always the opportunity for licensing further down the road.

- Operator - -

A. Okay. And backlog, are you able to discuss what your backlog was at the end of '17?

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer

A. We'll be able to provide that number with our 10-K filing around March 2.

- Operator - -

A. I see. (inaudible)

- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

A. But just from a directional standpoint, I would just add, we're in the best position. We have the best visibility we've ever had into a new year exiting 2017 and entering 2018.

- Operator - -

A. No, I appreciate that, Chris. I mean, I guess I'll wait for the actual figures in your K. But just again, directionally, would it be safe to assume that, let's say, over 50% of your revenue guidance of \$40 million is contracted backlog at this point?

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer

A. I don't think the company has ever had anything that high. We also -- I mean, it's below that, but it's much, like Chris said. It's larger than it has been over the last couple of years, and so we have a lot more visibility than we've had over the last couple of years. And the backlog number include -- does not include extensions where we haven't actually recontracted with. But the extensions have higher probabilities to them than new business does normally.

- Operator - -

A. Got it. And my last one is just to clarify. So your first quarter guidance that you provided, that assumes that all Micron license is not incorporated there, correct. That's already gone away after the end of the year.

- Bill Roeschlein - Intermolecular, Inc. - CFO & Principal Accounting Officer

A. That's correct. The Micron royalty ended in the December quarter, and so there will not be any more of that in the future quarters.

- Operator - -

A. (Operator Instructions) And I'm showing no further questions. I would now like to turn the call back to Mr. Chris Kramer for any further remarks.

- Christian F. Kramer - Intermolecular, Inc. - CEO, President & Director

A. Just thank you all for your interest and look forward to speaking with you next quarter. Thank you.

- Operator - -

A. Ladies and gentlemen, thank you for your participation in today's conference. This concludes today's program. You may all disconnect. Everyone, have a great day.