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IMI - Q4 2016 Intermolecular Inc Earnings Call

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CORPORATE PARTICIPANTS

Rick Neely *Intermolecular, Inc. - SVP, CFO*

Bruce McWilliams *Intermolecular, Inc. - Executive Chairman*

Chris Kramer *Intermolecular, Inc. - President, CEO*

CONFERENCE CALL PARTICIPANTS

Arthur Su *Needham & Company - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Intermolecular, Inc. Fourth Quarter and Full Year 2016 Earnings Conference Call. (Operator Instructions). Please note, this call is being recorded. My name is Cherie, and I will be your operator for today. I would now like to turn the conference over to your host for today, Mr. Rick Neely, Senior Vice President and Chief Financial Officer. Please proceed, sir.

Rick Neely - *Intermolecular, Inc. - SVP, CFO*

Thank you, Cherie. Good afternoon, and welcome to Intermolecular's fourth quarter and full fiscal year 2016 earnings conference call. We announced our results after the market closed today, and you will find a copy of the press release on our website at www.intermolecular.com. On the call with me today are Bruce McWilliams, Executive Chairman, and Chris Kramer, President and Chief Executive Officer.

Today's conference call contains forward-looking statements. Any statement that refers to expectations, projections, or other characterizations of future events, including 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. 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 2015, 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 measurements 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 Kramer - *Intermolecular, Inc. - President, CEO*

Thank you, Rick. Good afternoon, everyone, and thank you for joining us on today's call. Since I joined IMI in August, we have started three major efforts. First, focus on establishing long-term agreements with key customers to build a foundation of anchor customers who represent a significant portion of our revenue. I am happy to report that we have signed a multiyear agreement with a leading semiconductor company, and that negotiations with other customers are progressing.

Second, increase our pipeline of programs and customers. Our new sales and marketing team has done a very good job expanding IMI prospective customers and identifying opportunities to expand business along the semiconductor supply chain and beyond semi. We are now defining and scoping programs of companies that never did business with IMI in the past. We are also engaging with former customers who see great benefits



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in our new service model. These key industry players appreciate the value of our technology and team and are interested in exploring services to advance their R&D. We are anticipating signing on new customers throughout 2017.

Third, streamline and optimize our operations. The restructuring we undertook in the third quarter was successful as we reached our financial targets for the end of 2016. We continue to closely monitor our costs and investments, and as a result we kept our EBITDA loss at less than \$600,000 in Q4. We are now in a better position to manage our growth and diversification.

We closed the year with \$47.3 million revenue, a 4% increase over our 2015 revenue of \$45.3 million. What is significant for me is that we increased our program's revenue to \$39.7 million in 2016 from \$33.7 million in 2015, a 17% increase year-over-year. We are gradually building the foundation of our technology platform services business, IMI Labs. Our customers are very satisfied with our technical accomplishments and they value the expertise and support we provide. Advanced semiconductor device development is extremely complex, and we offer a state-of-the-art FAB, equipment and technical staff that allow our customers to perform experiments in an environment that will not impact their production line. It is key for the advancement of their R&D. IMI's value proposition is well aligned with the needs and strategic direction of the industry.

Semiconductor remains the core of our business, but our efforts to diversify beyond semi are starting to pay off. In 2016, nonsemi programs generated \$11.9 million of revenue compared to \$9.5 million in 2015. We have now completed our CDP with Guardian Glass and demonstrated the added value that IMI can bring to the nonsemi industry. We continue to engage outside of semiconductor with leading alloys and optical coatings customers. There is very strong interest, but these industries have different cycles than semiconductors, and we are adapting our services to serve these needs.

Our Q4 revenue of \$10.5 million was in line with our expectations, and we would remind investors that building and expanding our pipeline will take time, but we are seeing steady improvement.

In summary, we are making good progress in signing key customers to longer term agreements, creating a steady, growing program business, and we see a good number of opportunities in the pipeline that IMI could capitalize on. We will continue to see choppiness in the coming quarters as we are putting in place these long-term agreements with more customers while at the same time some programs will naturally conclude. We have adjusted our expenses to be able to build our business in a stable manner while meeting financial expectations. I am confident that IMI has all the elements to succeed in being a premier partner in materials innovation. Now, I'd like to return the call to Rick to go over our financials.

Rick Neely - *Intermolecular, Inc. - SVP, CFO*

Thank you, Chris. Let me review some selected financials for the fourth quarter and full fiscal year of 2016. IMI revenue for the fourth quarter was \$10.5 million, which was relatively flat in the third quarter of 2016, but down 19% from Q4 the prior year. For fiscal 2016, IMI revenues was \$47.3 million compared to \$45.3 million for fiscal 2015, an increase of 4%. Q4 program revenue of \$8.8 million represented approximately 84% of total revenue in the fourth quarter with licensing and royalty revenue coming in at 16% for the quarter.

While our program revenue did not grow in the fourth quarter, our total annual program revenue of \$39.7 million for 2016 showed significant growth over the \$33.9 million we logged in 2015 program revenue, an increase of 17% year-over-year. This result reflected an overall strengthening of our business in our core semiconductor memory area year-over-year, as well as solid progress with new customers in nonsemi areas.

In Q4 2016, we had three customers which were each greater than 10% of total revenue. These three customers represented approximately 71% of total revenue in the fourth quarter of 2016. Net loss in the fourth quarter of 2016 on a GAAP basis was \$3 million, or a loss of \$0.06 per basic share. This compares to a net loss of \$6.8 million, or a loss of \$0.14 per basic share in the previous quarter. Our Q4 2016 net loss decreased from prior quarter due to the significant restructuring activities and impairment losses undertaken by the Company in the third quarter.

Looking at our complete fiscal year results, our 2016 net loss was \$15.4 million, or a loss of \$0.31 per share compared to a net loss of \$21 million, or a loss of \$0.44 per basic share in fiscal 2015. This 27% year-over-year profit improvement on a relatively small revenue increase was a result of operational improvements, increased program margin, and headcount reductions that better aligned our costs to our program service business. 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



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those results. The key difference from GAAP to non-GAAP measures is the exclusion of stock-based compensation expense. On this basis, we reported a non-GAAP net loss for the fourth quarter of 2016 in the amount of \$2.3 million, or a loss of \$0.05 per basic share. This compares to a non-GAAP net loss of \$5.9 million, or a loss of \$0.12 per basic share in the third quarter of 2016.

For the full fiscal year, our 2016 non-GAAP net loss was \$11.8 million, or \$0.24 per share, an improvement of 23% from our 2015 non-GAAP net loss of \$15.3 million, or \$0.32 per share. The primary reason for the significant decrease in our non-GAAP loss in the fourth quarter was the cost reduction actions we took in September 2016. We made extensive organizational changes that resulted in reduced headcount for IMI, and took severance cost of approximately \$1.1 million in Q3, as well as write down the \$900,000 in equipment and \$950,000 in unused patent assets in the third quarter of 2016. We are seeing the benefits of these actions in the fourth quarter results.

Gross margin in the fourth quarter on a non-GAAP basis was 68%, which was equal to our gross margin in the prior quarter and down slightly from Q4 of 2015, when our non-GAAP gross margin was 69%.

On a full fiscal year basis, our 2016 non-GAAP gross margin was 68% compared to 60% in fiscal 2015. Our improved gross margin demonstrates the potential profitability in program revenue run under the new business model.

In the past several conference calls, we have mentioned that we are highly focused on getting back to positive cash flow, and the proxy we are using internally is positive adjusted EBITDA. For the fourth quarter of 2016, our adjusted EBITDA was a loss of \$584,000, compared with a EBITDA of \$2.1 million in the third quarter. For the fourth quarter, we had \$1.7 million of ongoing depreciation and amortization, and \$0.7 million of stock-based compensation that were in the noncash charges we netted against our GAAP net loss of \$3 million for the fourth quarter.

As of December 31, 2016, our balance sheet included cash and investments of \$27.8 million, which was down \$4.1 million from the combined total of \$31.9 million at the end of the third quarter of 2016. This was largely a result of collection timing differences as we collected \$3.5 million in the first week of January, but this affected our year-end reported total cash.

In summary, we were pleased that our fourth quarter financial results reflected our commitment to achieving cash flow break-even and then P&L profitability as early as practical. We took significant cost reduction actions in the third quarter of 2016, and we saw the results of those actions in the fourth quarter of 2016. Now, I would like to return this call to the operator for any questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from Edwin Mok with Needham & Co.

Arthur Su - *Needham & Company - Analyst*

This is actually Arthur on for Edwin. Thanks for letting us ask a few questions, and congrats on the great quarter. Just to jump straight into it, maybe starting with semi first. In your prepared remarks you noted that you signed a multiyear agreement with a leading semi company. I was wondering if you could provide a little bit more color, whether this company is in memory or (inaudible) logic, and when we can start to see revenue contribution from this agreement?

Rick Neely - *Intermolecular, Inc. - SVP, CFO*

It's a memory player, and the contribution is immediate, ongoing.



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Arthur Su - *Needham & Company - Analyst*

Got it, thank you. Moving onto the nonsemi side, it sounds like nonsemi was making progress. You've made progress on nonsemi in 2016. I know in the past you have highlighted that you have won a contract with the Department of Energy and also with another Fortune 500 company. Is this a reflection of those wins, or is it other areas that are benefiting [from the] business?

Bruce McWilliams - *Intermolecular, Inc. - Executive Chairman*

This is Bruce. Yes. So, the areas, that work with the Department of Energy did spawn work with a major alloy manufacturer that was a significant portion of our revenue in Q4, and it's moving us into new areas as well, in protective coatings.

Arthur Su - *Needham & Company - Analyst*

Is that something that we can see on an ongoing basis, or is it still kind of lumpy in the nonsemi side?

Bruce McWilliams - *Intermolecular, Inc. - Executive Chairman*

We think it's going to be still somewhat lumpy but long-term it will a significant portion of our revenue.

Arthur Su - *Needham & Company - Analyst*

Got it, thank you. And then moving onto the financials. Gross margin, the second two quarters in a row we've delivered gross margin, what, about 68% level. I know in the past you've highlighted the structure change you've made in your program setup that has generated greater profit. Is this kind of like the level that we should think about as we move into 2017 with 68% gross margin?

Rick Neely - *Intermolecular, Inc. - SVP, CFO*

This is Rick. Actually, we're pleased that we're a little bit above our target. We generally expect to be 60% to 65%. We certainly like 68%. A lot of it gets down to the mix the programs are doing at any point in time. I would say our long-term view is to be more in the 60% to 65% range. Some quarters we could be above it, as we have been.

Arthur Su - *Needham & Company - Analyst*

Thanks. The last question for me is, you guys have a very strong memory exposure. I think in the past you've highlighted that you served the top four [Autofac], top memory manufacturers. So, there's been industry chatter on the near-term strength in memory, especially with the 3D NAND recovery of DRAM. Are you seeing any near-term benefits because of these positive industry trends?

Chris Kramer - *Intermolecular, Inc. - President, CEO*

Chris here. I would say absolutely, I think that the strength in memory plays well to IMI strengths, and so as we continue to work with the leaders in memory, their need for new materials will continue, and competitive landscape for them will drive more work for us, we hope.

Arthur Su - *Needham & Company - Analyst*

Great. Thank you, that's all I had. Thanks for answering our questions.



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Operator

Thank you. (Operator Instructions) Speakers, I'm showing no further questions in the queue. I'll turn the call back over to you.

Rick Neely - Intermolecular, Inc. - SVP, CFO

Well, thank you very much, everyone, for coming to our fourth quarter conference call. We look forward to talking with you at the end of Q1 in -- this year. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may all disconnect and have a wonderful day.

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