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ATOM - Q1 2020 Atomera Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, and welcome to the Atomera First Quarter 2020 Earnings Conference Call. (Operator Instructions)

This event is being recorded and will be available for replay for approximately 1 week.

I would now like to turn the conference over to Mike Bishop. Please go ahead.

Mike Bishop

Thank you, and good afternoon. I'm Mike Bishop with the company's Investor Relations. Joining me on today's call is Scott Bibaud, Atomera's President and CEO; and Frank Laurencio, Atomera's CFO.

If you are joining by telephone, please go to the Events section of our Investor Relations page on our website to follow a slide presentation that accompanies our remarks. That presentation will remain available on our website after the call. After prepared comments by Scott and Frank, we will open the call up to your questions.

Before we begin, I would like to remind everyone that during today's call, we will make forward-looking statements. These forward-looking statements, whether in prepared remarks or during our Q&A session, are subject to inherent risks and uncertainties. These risks and uncertainties are detailed in the Risk Factors section of our filings with the Securities and Exchange Commission, specifically in the company's 2019 Annual Report filed on Form 10-K filed with the SEC on March 13, 2020. Except as otherwise required by federal securities laws, Atomera disclaims any obligation to update or make revisions to such forward-looking statements contained herein or elsewhere to reflect changes in expectations with regards to those events, conditions and circumstances.

Also, please note that during this call, we will be discussing non-GAAP financial measures as defined by SEC Regulation G. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures are included in today's press release, which is posted on our website.

Now I would like to turn the call over to our President and CEO, Scott Bibaud. Go ahead, Scott.

Scott A. Bibaud - Atomera Incorporated - President, CEO & Director

Thanks, Mike. And thank you all for joining us to hear about Atomera's progress during a very trying time in our lives and businesses. Let me start the call by saying that Atomera took measures swiftly as did many other California-based companies to be sure our employees and their families remained safe during this pandemic.

We have continued to work with customers and partners from around the world who have been exposed to all kinds of hardships, and we count ourselves lucky to have escaped some of the worst of this situation. I hope that you and all your families have been safe as well.

In times like this, it would be reasonable for our investors to expect Atomera to announce major slowdowns or cancellations of customer activities. In fact, that has not been the case. Our reality during the last few months has been better than might be expected in these circumstances. Most Atomera employees do engineering design, simulations and analysis that can be conducted remotely. For the few who need to work with specialized tools, accessibility under modified conditions has allowed our work to continue to progress without significant interruption. Most of our customers' fabs have continued to run during the past month. So our programs which were launched before the virus period have not been affected. Wafers continue to run, analysis is being reviewed and plans are being made for further work.

As a matter of fact, over the last 3 months, we have grown our customer pipeline. As most of you know, very few of our customers have ever dropped out of our development programs. But one of them that had dropped out has now started a new program, which has advanced into Phase 2. Several of our existing customers have 2 engagements underway. But now, for the first time, we have 1 customer that has added a third program to the work we are doing with them, and that program has already moved into Phase 3. This makes a record 26 engagements with 19 customers, 16 of the engagements are in Phase 3. We continue to talk with several other new prospects who are not currently in our pipeline, but are interested in working with our technology.

We are seeing some modest impact from the coronavirus, primarily in newer engagements. In general, I believe many companies in the semiconductor industry have started to become a bit more cautious on spending, especially on CapEx, until they can understand the long-term revenue impact of the coronavirus. A few of them have told us that they do not expect to have visibility until at least this June. So though we have not been impacted yet by customer cost cutting, we are starting to see some more conservatism on spending.

We have seen some delays in our customers' R&D engineering for new programs. For many of our customers, production personnel are working in the fab, but development engineers continue to work from home, which sometimes limits their ability to start new R&D lots that require handholding in the fab. So where some customers would normally be starting wafers, they may be holding back until their engineers get back into the office to start pulling the levers on new lots.

In our last update call, we spoke about developing deeper and more strategic relationships with customers through joint development agreements. We are advancing our work on this new agreement format with several large customers, customers with multiple production nodes and multiple technology and product divisions, an approach that integrates both development, licensing components and manufacturing requirements. But the execution of those agreements has been somewhat impacted by coronavirus.

First, our ability to personally fly to customer sites and close deals with face-to-face negotiations has obviously been halted. Negotiations continue over the phone and email, but take a bit longer. Second, uncertainty in end market demand has caused at least one of our potential JDA partners to become more cautious on spending and to postpone the beginning of a program they're planning with us. We continue to be huge believers in joint development agreements because we expect that they will give us an advantage on both leading and trailing edge technologies and will provide access to a variety of platforms, ultimately leading to deeper customer penetration, faster adoption and quicker ramping of manufacturing activities across their product lines. But adoption of these JDAs has been delayed at least a month and maybe longer.

I do want to emphasize one thing. None of our JDA discussions have stopped; they are just delayed. We believe that this trend is very positive for Atomera and will help us to become more successful with bigger customers.

Finally, in terms of coronavirus impacts, I will say that the lack of visibility is having some impact on production plans of our license partners as their markets and CapEx plans may be changing.

Although there are uncertainties in the market, inside Atomera there's a lot more clarity. We are busier than ever working on R&D programs, perfecting our simulations, interacting with customers as we design, revise and analyze the ongoing wafer runs we are conducting with them and plan for new runs.

I'd like to give you some insight into what we've been able to accomplish during this time period. In the last earnings call, I spoke about how Atomera's R&D has achieved extraordinary results with our MST SP technology, allowing our specific on-resistance, or RSP, to reach a level that is slightly better than the industry top runners. Since then, we've been able to reduce that critical metric even more, to the point where we believe our MST silicon fabricated at our contract foundry is now yielding a lower RSP than is available anywhere in the world on that process node. Those results will be even more impressive when fabricated on the significantly more advanced processes used by our customers. Remember, that the lower the RSP, the more compact and efficient a given power management IC can be. So MST SP would enable a very attractive cost reduction to makers of mobile phones or any battery-operated product. We are working with several different customers in this area.

MST on RF SOI continues to be a product area with excellent potential. Our customer base continues to grow and conduct extensive tests of the technology. This past quarter, we were invited to present a paper on those technologies at the EDTM conference conducted in March, and it was very well received. And the new matching data that we covered in the last call and on our blog have been accepted for another upcoming conference on semiconductor reliability, coming soon. We think that this technical publicity will lead to even more customer engagements.

As mentioned in prior calls, we've been working for the last few years to secure a full-time lease on a 300-millimeter or 12-inch epitaxial deposition tool. I'm pleased to report that the tool has now been delivered and is currently in the process of being installed. If all goes well, we hope to take possession of the tool and begin epi deposition at the end of this quarter.

Let me just take a moment to elaborate on how much this tool will enhance Atomera's position in the market. Since 2016, Atomera has leased a 200-millimeter or 8-inch epitaxial deposition tool. This, in conjunction with our foundry partner, has dramatically improved our R&D capabilities to the point where our cycles of learning in the company went from 3 to 4 cycles per year to more than 30 cycles per year. Since many of our customer engagements have been at 130 nanometers and above and used 200-millimeter wafers, this facility is very useful for MST deposition during customer integration runs as well as for our internal R&D. Below 130-nanometer, every process node uses 300-millimeter wafers exclusively. So most of our customer engagements use this wafer size as well.

There really are no facilities in the world that one can access to lease a 300-millimeter epi tool on a regular basis. So when we've had to do customer integration runs on 300-millimeter wafers, we have had to negotiate with one of our epi OEM partners to give us access to their labs for a short period. This type of arrangement has always limited us because tool access is rarely available and when it is, it's only for short periods and it's very expensive. Therefore, when we did get access to a tool, we needed to fit in as many customer runs as possible and run them as fast as we could. As you can imagine, this is not the best environment for careful experimentation and thoughtful creativity. In many cases, we tried to use 200-millimeter wafers for our customers' 300-millimeter experiments, leading to the need for specialized equipment, handling errors and other problems.

Because semiconductor manufacturers prefer to see experiments under conditions that replicate their production environments as closely as possible, we also have had customers who have run experiments in 200-millimeter wafers with us who have deferred progressing their work until we can demonstrate results on 300-millimeter wafers. We expect that we can cut down on these inefficiencies with the new tool.

With this new capability, we will finally be able to take the time necessary to ensure earlier success on customer epi runs. We will be able to accommodate more customers running more experiments, and it opens the possibility for Atomera to help customers who need more wafers as they transition from development to pilot runs to early production. Because this will be a state-of-the-art tool, it will also allow us to make process improvements that will allow our customers to transition to a production facility more readily.

Since the more advanced nodes use 300-millimeter, this also helps us to more directly address the higher royalty potential segment of the market. Early on, we identified that a 300-millimeter epi tool was one of the most critical pieces of equipment to enable Atomera to make a big impact in the market, and we are now on the verge of that dream becoming a reality.

As you can see, during a major slowdown in the economy, Atomera has continued making progress at a fast pace. Nevertheless, we need to be especially prudent on spending. So we have cut discretionary spending wherever possible. On our last update call, I talked about how our potential at this point is being limited only by our internal resources, and that is still true. We will not forsake growth in order to save the expense of a few new hires, but we will add them cautiously as we gain visibility. As you know, we are very conservative with our cash, but the potential growth we

can see is something we must take advantage of. Despite the COVID situation, very few of our activities have slowed. Customer penetration is increasing and the focus is favoring near-term manufacturing processes.

Now I will turn the call over to Frank to review our financials.

Francis Laurencio - Atomera Incorporated - Chief Financial & Accounting Officer and Corporate Secretary

Thank you, Scott. At the close of the market today, we issued a press release announcing our first quarter 2020 results. This slide shows our summary financial results, and I will now review them in more detail.

Our GAAP net loss for the 3 months ended March 31, 2020, was $3.6 million or $0.22 per share compared to a net loss of $3.5 million or $0.24 per share in the first quarter of 2019. GAAP operating expenses were approximately $3.7 million in both Q1 2020 and Q1 2019, while both revenue and interest income declined slightly. Our lower net loss per share was due to an increase in weighted average shares outstanding from 14.8 million in Q1 of 2019, to $16. 8 million in Q1 2020.

Revenue in Q1 2020 was $62,000, compared to $71,000 in Q1 2019. Revenue in both periods was derived from integration license agreements.

Our press release and this slide contain a reconciliation between our GAAP and non-GAAP results. Although GAAP net loss increased slightly compared to Q1 2019, from $3.5 million to $3.6 million, our non-GAAP adjusted EBITDA, which excludes most non-cash items, remained flat at $2.9 million in both periods. As is typical for us, the biggest difference between our GAAP and non-GAAP results is stock compensation expense, which was $629,000 in Q1 2020, compared to $694,000 in Q1 2019. Q1 2020 also included $138,000 charge related to a warrant that had been issued in connection with our pre-IPO financings.

Non-GAAP research and development expense was $1.8 million in Q1 2020, approximately $114,000 less than our $1.9 million of R&D expense in Q1 2019. This decrease was due to lower outsourced fabrication and testing expense, which declined by $180,000, offset in part by new-hire payroll expense.

As we discussed in prior calls, during Q1 and Q2 of 2019, we increased our R&D spending ahead of our budget as we focused engineering effort on development of MST SP. But we were still able to finish 2019 with R&D spending on plan as we pulled back on these increases in the second half. I will go into more detail later about R&D expense components and the quarterly trends.

Non-GAAP G&A expense in Q1 2020 was $927,000, compared to $829,000 in Q1 2019, mainly reflecting increased spending on professional fees.

Sales and marketing expenses were approximately $200,000 in both periods, declining slightly in Q1 2020 compared to Q1 2019. Travel expenses for all departments declined as a result of coronavirus restrictions.

On a sequential basis, our GAAP net loss in the first quarter of 2020 was $3.6 million compared to a $3 million net loss in Q4 2019. The higher net loss quarter-over-quarter reflected lower revenue, which was $62,000 in Q1 compared to $138,000 in Q4 of 2019, as well as higher operating expenses, which were $3.7 million in Q1 compared to $3.2 million in Q4.

GAAP net loss per share was $0.22 per share in Q1 2020 compared to $0.18 per share in Q4 2019. Non-GAAP adjusted EBITDA of $2.9 million in Q1 compares to $2.4 million in Q4, reflecting a $234,000 increase in R&D expense and a $182,000 increase in G&A expense. Higher sequential R&D expense reflected an increase in outsourced fabrication and tests as we processed a record number of wafers in Q4 and Q1, with most of the associated expenses occurring in Q1 as well as the addition of new headcount in Q1. The increase in G&A was primarily due to the timing of professional fees.

Sales and marketing expenses were flat from the previous quarter.

Cash balance at March 31, 2020 was $11.4 million, a decline of approximately $3.5 million from our $14.9 million balance at year-end. As has been the case for the past 3 years, our cash used during the first quarter is higher than in other quarters due to the timing of annual payments that are expensed ratably over the course of the year.

Consistent with our past practice, we are only providing revenue guidance for the current quarter. Due to the delays created by the coronavirus travel restrictions and the impact on our customers' business, we are now expecting to have no revenue in Q2 2020. But as Scott indicated in his remarks, none of our customers have ceased work on MST and progress on the JDA contracts has been delayed but not canceled.

Our recent customer discussions on the JDA contracts reaffirm our conviction that these agreements will provide a more structured path to getting MST installed and moving toward production.

As Scott mentioned in his remarks, the impact of coronavirus on our customers' business and the associated uncertainties that creates have caused us to reduce all discretionary spending. And we will closely monitor timing of new hires and all other planned expense increases. Accordingly, we are reducing our guidance for 2020 non-GAAP operating expense to a range of $12.75 million to $13.25 million.

With that, I will return the call back over the Scott for a few summary remarks before we open the call up to questions. Scott?

Scott A. Bibaud - Atomera Incorporated - President, CEO & Director

Thanks, Frank. As you have heard on this call, while the coronavirus has caused some minor delays in our programs, our business has continued to grow stronger during this period. Our engagement numbers continue to grow with an even larger stable of customers running multiple programs. Both Atomera and our customers continue to be committed to the JDA agreements we introduced in February. Our focused technical areas continue to gain notoriety in the industry and we are building on their success. Our new 300-millimeter epi tool is going to give Atomera capabilities that should enable us to accelerate programs in higher revenue potential process nodes.

We continue to execute aggressively to take advantage of the momentum we've built during this period, and I believe that Atomera will exit from this coronavirus period stronger than ever. I look forward to sharing the results of those efforts with you in the future.

Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question or comment comes from the line of Cody Acree from Loop Capital.

Cody Grant Acree - Loop Capital Markets LLC, Research Division - MD

Thank you for taking my questions and [stating] a strong progress even given the current environment, unfortunately.

Frank, could you talk about the expense associated with the 300-millimeter tool? And do you have any associated drawdown of your leasing expenses on your 200-millimeter tool?

Francis Laurencio - Atomera Incorporated - Chief Financial & Accounting Officer and Corporate Secretary

Yes. So those expenses on the 300-millimeter tool eventually do replace the 200-millimeter tool. So the exact sort of timing of when the new expenses commence and others would draw down really is dependent on the acceptance of the tool. It's both delivery by the vendor and also

acceptance by us. So there's a little bit of uncertainty there. I guided an increase in spending this year over last year. And even with some reduction, we will have our operating expenses about $1 million higher than last year. That being said, only a small part of that is reflected in the tool, because, as you accurately pointed out, these are not going to be additive expenses; one comes in place of the other.

I'm not ready to give exact guidance on the timing, because there's a part of this that's subject to when the acceptance takes place. And as you can imagine, that process will impact the amount of usage that we need of other tools. Scott even alluded to the fact that our current status quo is if we need to do 300-millimeter evaluations, we need to do some spending to get access to those tools at a higher cost. Until we have the new tool totally up and running, we can't be sure that that won't happen again. We have some buffer built in for that, should we need it.

But, yes, Cody, unfortunately, I can't give you sort of an exact date of the switchover.

Cody Grant Acree - Loop Capital Markets LLC, Research Division - MD

Sure. Maybe for Scott then. The JDA potential that you're working with, even though the timing of actual the engagements may be unclear, if you had to look at the potential pipeline of signing of those JDAs, what does that look like? Or is there any way to quantify?

Scott A. Bibaud - Atomera Incorporated - President, CEO & Director

Yes. I think, so we've been talking to people about multiple JDAs. And so a couple of different, I'd say timings that would come to the [floor]. With one of our JDAs, we thought we were very far along in negotiations on that when the coronavirus struck and slowed things down. Discussions continue on that. I'm hopeful that we'd be able to still close that one in the nearer term. I can't tell you exactly when, for obvious reasons. When we negotiate with these large companies, they move at their own pace, with their own pace. Their decision-making process is quite opaque to us. And so we have made it a policy to not announce when we're going to close something until it's literally closed.

With another of our JDA customers, they are starting to worry about some cost, some cost concerns, and so that one will probably be delayed a little bit longer. But again, we continue to talk with them about doing the JDA. And so I think that one might be a little later out in the year.

Cody Grant Acree - Loop Capital Markets LLC, Research Division - MD

I see. Thank you. And then lastly, just, Frank, what is kind of a base level, minimum level of cash that you're comfortable operating the company with?

Francis Laurencio - Atomera Incorporated - Chief Financial & Accounting Officer and Corporate Secretary

Yes. That's something that, obviously, we look at carefully. And we have no near-term plans to raise any additional capital. But that's something that we'll continue to monitor very closely and monitor the market conditions, which, obviously, have been pretty volatile in recent months.

Operator

(Operator Instructions) Our next question or comment comes from the line of Suji Desilva from Roth Capital.

Suji Desilva - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Good job on the progress here in a challenging environment, for sure. I ask this question I think of Scott every call. Which of the nodes, technology nodes do you think, kind of 3 months advanced here, that you think has the best near-term opportunity to turn into licensing across the trailing edge and some of the leading edge?

Scott A. Bibaud - Atomera Incorporated - President, CEO & Director

Yes. Suji, I think, so we talk about a few different focused areas, especially we've been talking about RF SOI and the power management and areas. And so we actually believe that RF SOI has the potential to be an earlier ramp to production, because it's using our MST1 technology which is easier to integrate and easier to adopt by a factory, basically because they're kind of taking bulk silicon with MST on top of it and starting it at the front of their line. So we're very hopeful about that one.

But the power management business is a extremely large and lucrative market where we think we have a very strong technical offering right now with our MST SP technology. And so if we can achieve widespread adoption there, then that would be a much bigger business. So both of them are great if you think the -- I mean, if the answer is which one would happen first, I would probably put my money on RF SOI. But the other one is also extremely attractive.

We've also spoken in the past about our work that's going on in kind of on the bleeding edge. And that one typically will probably take a little bit longer. Bleeding edge technologies take some time to develop. But the good news is, if we're adopted as it goes to production, there's a good chance we could be adopted across multiple players in the industry with that.

Suji Desilva - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Okay. And then on the customer side, the new engagement clearly added an interesting customer, and now up to 3 engagements in 1 customer. Is that kind of traction that you're getting, which is very impressive, is that kind of traction kind of a precursor indication that JDA-type agreements are the kind of thing customers are interested in? Is that the right way to read the fact that you're broadening out of the customers you already have?

Scott A. Bibaud - Atomera Incorporated - President, CEO & Director

Yes, I think that's actually -- I hadn't put that connection together or anything. But that's very [bright] of you to pick that up, because that's exactly what a JDA tries to capture. This customer who is expanded to 3 things right now, we started working on 1 technology with them, they were seeing good benefits. Then other groups started to say, on my technology this might be really useful too, so we did that. On the second one, both of them seemed to be having some nice looking results, and so now a third one's coming onboard.

What a JDA would typically do is that a central organization would evaluate our technology and then approve it for going to production. And then all of the different business units who are interested in using it could kind of take advantage of that early work and maybe even get it to production faster since it would be preapproved. So yes, so I think, we're hoping that what we're accomplishing with this customer who's doing 3 programs with us now will also be -- will be enabled by doing JDAs with other large customers.

Suji Desilva - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Okay. And then my last question for Frank, perhaps. On the 300-millimeter tool you're going to be putting in, as that gets running, is this the right way to think about this, that because the runs you were doing before were outsourced, it could be a cash burn benefit of having the tool in house? Is that the right framework to think about the benefit? Or is it just more productivity at the same cost?

Francis Laurencio - Atomera Incorporated - Chief Financial & Accounting Officer and Corporate Secretary

I think it's -- well, it's more productivity. It'll be a slightly higher cost than what our run rate was in the past, but it's also a much more predictable run rate of expense on it because we won't have the episodic need to go out and get short-term capacity, which we have to pay a premium for and do it less efficiently. So, yes, it'll be on a steady-state basis, higher expense, but it's a more predictable and more efficient use of our money for that.

Suji Desilva - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

That helps frame it. Thanks. Great job on the progress, guys.

Operator

I'm showing no additional questions in the queue at this time. I would like to turn the conference over to Mr. Bibaud for any closing remarks.

Scott A. Bibaud - Atomera Incorporated - President, CEO & Director

I want to thank you all for attending today's presentation. Atomera is pleased to be able to report our growing momentum and progress towards unlocking what we believe is our huge potential in 2020. Please continue to look for our news articles and blog posts to keep you up-to-date on our progress. You can sign up for them along with investor alerts on our website, atomera.com. Should you have additional questions, please contact Mike Bishop, and we'll be happy to follow up. We look forward to seeing some of you during our scheduled marketing activities such as the Oppenheimer Emerging Growth Virtual Conference on May 12. And we thank you again for your support and look forward to our next update call. Stay healthy.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone have a wonderful day.