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Q3 2018 Atomera Inc Earnings Call

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PRESENTATION

Operator

Good afternoon and welcome to the Atomera Third Quarter 2018 Earnings 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.

We have posted a presentation to accompany our prepared remarks, and it is available in the events section of the Investor Relations page of our website. That presentation will remain available on our website after the call. After prepared comments by Scott and Frank, we will open up the call for your question.

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 the 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 perspective supplement filed with the SEC on October 11, 2018. Except as otherwise required by federal securities laws, Atomera disclaims any obligation to update or make revision 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 also 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***

Thank you, Mike. Welcome to the call everyone. And I'm glad to have the opportunity to give you an update on the progress we've made in the last quarter. These last 3 months have been a transformative period as we signed our first 2 license agreements and firmly established our balance sheet for the next phase of the company's growth. During our call today, I'll provide a summary of our recent accomplishments, then turn it over to Frank for a review of our financial results. After that, we will open up to your question.

Atomera is a materials and intellectual property licensing company with a proprietary transistor enhancement film called Mears Silicon Technologies or MST. Our company developed and helped customers integrate material technologies designed to improve the performance of semiconductors manufactured in both existing and new fabs. Our goal is to address the slowdown in Moore's Law by providing new materials and techniques to the industry. Atomera is not a manufacturer, but is an IT provider granting customers the right to manufacture with our technology in exchange for our license fee and royalty payments on shipments of their products.

Atomera has achieved several significant customer and financial milestones since our last call in August, with 2 license agreements, 2 new customers in our pipeline, the completion of an equity financing, as well as continued progress with customers and in our own R&D. Let me provide more details on each of these.

On September 25, Atomera announced our first commercial license agreement with Asahi Kasei Microdevices or AKM. AKM is a Japanese maker of semiconductor devices for the consumer, automotive and industrial market, and is known for technology leadership in the analog space. Atomera is particularly pleased to have AKM as our first licensee, since we have worked with them for several years and they have an exceptionally deep understanding of how MST can benefit their products.

AKM has executed in integration license with us, meaning they have paid us for the right to integrate our technology on their way first. Our licenses have 3 stages: integration, manufacturing and distribution. I'll provide more detail on the structure of our licenses later in my comments.

On October 2, we were able to announce our second commercial integration license with STMicroelectronics, one of the world's largest semiconductor companies with annual revenue over $8 billion. ST is a leading European provider of semiconductor solutions across many markets, but principally in the areas of smart driving and the Internet of things. This license with ST shows how quickly a customer can adopt our technology since it took less than 2 years from our -- the start of our work with them until they signed up for a license.

In our view, until an IP licensing business successfully charges customers to license their technology, they are still in the development phase. With the completion of our first 2 revenue bearing license agreements, Atomera has officially entered our commercial phase. And we will continue working aggressively to sign new license fees and move our customers into volume production.

We have been speaking about our model of upfront license fees and production royalties for some time, and these first 2 agreements validate the acceptability of our model to the industry. It is important to understand that customers do not sign a license agreement casually. In both cases, these investments in MST had to go to a very senior level of management, accompanied by a plan or how they would ultimately take this technology to production before receiving approval for license execution.

On October 15, we closed the public offering of 2.625 million shares of common stock that resulted in us raising approximately $11.5 million after fees and expenses. As a result of the offering, we have now successfully strengthened our balance sheet and positioned the company such that if we continue to execute our business plan, we will not need to return to the capital market. We expect to use the proceeds from the offering to support customer integration of MST with outsource spending on deposition and testing, as well as additional engineering headcount.

ROTH Capital was our sole book running manager, National Securities was the co-manager, and we were advised by Loop Capital. It is our opinion that the financing profits was well run by all parties. Our road show was very well received and we have successfully captured the interest of many sophisticated institutional investors with expertise in emerging growth technology companies.

We were pleased to close the financing with both these new investors and existing shareholders who reinvested in Atomera in a market that turned challenging in the final hours. With this infusion of capital, we believe the company is now stronger and better positioned than ever before. Frank will provide more details of the transaction in his financial review.

In addition to the license and financing activities, our work with customers has continue to progress very nicely. As a review, Atomera represents customer activity with the phases of engagement shown here on Slide 6. Phase 1 includes customers under NDA who are planning an evaluation of our technology. In Phase 2, we deposit our MST film on customer's wafers and conduct physical characterization. Phase 3 is where customers in corporate MST during the production of their wafers and use the test results to justify licensing our technology. It is generally in Phase 3 that we are most likely to sign license agreement with customers. In fact, our engagements to both AKM and ST are in Phase 3. Phases 4 and 5 are where customers install our technology in their fab and transition to production.

I'm pleased to share with you that during the last 3 months, Atomera has added 2 new customers and engagements to our pipeline. One additional engagement is now in Phase 1, and we have added 2 new engagements to Phase 2. With these additions, today we have 20 engagements underway with 16 different customers and 11 engagements during that critical third integration phase. Four customers continue to work with us on multiple notes or technologies simultaneously.

As I have said on prior calls, we believe that the cycle time on customer test vehicles has been slower than normal due to the very high capacity utilization of industry factories. Today, we are starting to hear about softening of demand in the industry which may benefit us by allowing us more and faster R&D wafer run. Although it is too early to see this release just yet, Atomera will push our customers to accelerate integration work as capacity becomes available.

Our relationship to their customers remains very strong and we continue to see commitment on their side to finalize integration and move towards licensing and volume production as soon as possible. Because we have heard some confusion from investors about the structure of our licenses, we want to spend a moment here on Slide 8 reviewing it. I'd like to emphasize from the start that although license stages are triggered by the customer's progress through the development phases, they do not add additional time or steps to the overall process. Atomera has 3 different sources of revenue: engineering services, license fees and royalties.

Customer EPI deposition work as well as integration consulting makeup engineering services revenue. Previously, we had rarely charged for these services, but we expect this revenue will grow as our customer engagements expand. When we execute a license with a customer, we charge them upfront license fees. A full license from Atomera grants customers' integration, manufacturing and distribution rights with milestone payments triggered as they reach the phase of development where these rights are needed. This license structure is standard in the industry. Of course, as in any license, customers can opt out of later stages if they decide not to pursue them. But the intent by both parties is that they will complete all 3 and go into volume production.

The full level of improvement MST provides cannot be fully quantified by customers until the end of the integration phase. Since we have very data driven customers, this lack of clarity has prevented us from executing full license agreements in the past. Therefore, in order to lower the barrier to a license decision, we have started negotiating the full license at the term sheet level, but have then broken down the agreement into 3 components that correspond to the major rights granted. These are the license stages I described earlier. Because the license fees get larger as the customer gains more MST-specific data in the later stages, we find that separating the grant of rights into separate components makes it easier for customers to reach management approval to begin the licensing process.

This leads to earlier business discussions on terms and we believe buying at higher levels of management sooner in the process. It also provides us with an earlier revenue flow. Both ST and AKM have executed an integration license with Atomera. In order to conduct EPI deposition on wafers in their own facilities, customers need a manufacturing license with us. Typically, this installation process will take about 3 months. Customers would then qualify their production line, a process which takes approximately 9 months, and must add distribution rights before they can sell product using MST.

At this point, they will be in production and will start providing royalties to Atomera. Although there are 3 stages to the license, it is typical that a customer will review and negotiate the full license at a term sheet level to ensure there is a meeting of minds. So the likelihood that the license process will reach an impasse later down the line and delay the overall development process is extremely low. Indeed, our experience negotiating our first 2 licenses indicate that they can be done relatively quickly.

During the last quarter, Atomera has been allowed 4 additional patents, all of which have now been issued by the U.S. Patent and Trademark Office, taking our total to a 184 patents granted and pending worldwide. We continue to expand our IP portfolio with important fundamental patents related to MST method, device and architectures for use in specific products and markets. Of course, our patent portfolio is the core of our license strategy, but we also license know-how. And as our many years of experience developing MST film and integrating into customer devices grows, so does the size and value of our know-how portfolio. Taken in conjunction with the fact that our technology is discoverable in the field and therefore defensible, the value of our company grows every day.

The last 3 months have been the most significant for Atomera since we were first established. We have closed on our first 2 customer license agreements, which will make each additional one easier. Already we can see that these announcements have given us a new level of credibility in the industry. We closed a round of fundraising in a very difficult market environment, adding solid institutional investors and extending our relationship with many existing ones. We have added new customers to our pipeline and made great progress with existing ones as well. Atomera is executing very well right now. And we believe that this success will translate into additional license agreements across the rapidly growing semiconductor industry.

Let me now turn the call over to Frank for comments on our financial results. Frank?

Francis Laurencio ***Atomera Incorporated - CAO & CFO***

Thank you, Scott. At the close of the market today, we issued a press release announcing our operating and financial results for the third quarter of 2018. These are shown on Slide 10, which I'm showing now. Our GAAP net loss in the third quarter of 2018 was $3.4 million or $0.28 per share, compared to a net loss of $3.3 million, which was also $0.28 per share in the third quarter of 2017. The higher net loss was due to higher payroll expenses from increased headcount and bonus accrual as well as higher expenses related to outsourced fabrication and testing.

These increases were offset in part by a $285,000 decrease in stock-based compensation expense as awards triggered by the closing of our IPO that had a 1 year vesting term became fully vested in August of 2017. GAAP net loss on a per share basis remains flat at $0.28 per share as the increased net loss was offset by a small increase in weighted average shares outstanding.

Non-GAAP adjusted EBITDA in the third quarter of 2018 was a loss of $2.8 million, compared to a loss of $2.4 million in Q2 of 2017. The higher net loss is due to our increased spending on outsourced fabrication and testing as well as higher payroll expenses. Our press release in this slide contain a reconciliation between our GAAP and non-GAAP results. As you can see, the major difference between our GAAP and non-GAAP results is stock compensation expense which is a non-cash item.

Looking at our results on a sequential quarterly basis. Third quarter 2018 GAAP net loss was $3.4 million compared to a GAAP net loss of $3.2 million in the second quarter of this year. Non-GAAP adjusted EBITDA loss of $2.8 million in Q3 of 2018, compares to a loss of $2.6 million in Q2 of this year, as our operating expenses increased by approximately a $184,000 due to increased spending on outsourced fabrication and testing as well as higher payroll expenses.

Turning to the balance sheet. Our cash at September 30, 2018 was $10 million, a decrease of $2.3 million from $12.3 million at June 30, 2018. This was the same amount of cash consumed during Q2 of this year. We continue to expect that total cash consumption for the full year in 2018 excluding the proceeds received from our October financing, will be at or slightly below the $10 million guidance for cash usage that we've been providing.

During Q3, we booked $75,000 to deferred revenue, which we expect to recognize during Q4. Going forward, we expect that we will generally recognize revenue from fixed fees in our licenses at the time that our customer gains the right to use our IP, which will either be upon contract signature or when our obligations under the contract have been met. The revenue from our AKM and STMicroelectronics licenses will be our first licensing revenue. As we have discussed on earlier calls, we expect that we will also continue to generate revenue from engineering services such as deposition of MST on customer wafers and related analytical work, which result in higher cost of revenue and thus lower gross margin than license revenues.

Therefore, while we expect gross margin to increase as we generate more of our lot revenue from licensing, margin will continue to be variable over the next few quarters, depending on the mix of licensing and engineering services revenues.

As Scott discussed earlier, on October 11, we priced an offering of 2,625,000 shares of common stock at a public offering price of $4.75 per share. This offering netted us cash proceeds of approximately $11.5 million after payment of underwriting fees and offering expenses. We are proud to have been able to grow our customer engagements and license MST to customers this year, while maintaining our annual cash operating expenses at a rate of slightly under $10 million for the year. We believe that we can continue to scale our business efficiently without needing significant increases in operating expenses or hiring a much bigger staff.

However, as we support the growing number of engagements and as customers move to installation and manufacturing stages with MST, we do expect modest increases in operating expenses next year. These increases will likely come in the form of additional engineering headcount, as well as spending an outsourced epitaxial deposition capacity and wafer metrology. Our outstanding share count as of September 30, 2018 was approximately 12.4 million shares. And now that we have closed our equity financing, we have approximately 15 million shares outstanding.

Scott will give a few summary remarks before we open up the call to questions. Scott?

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

Thanks, Frank. Once again, we've had a very productive quarter. Atomera is a much more substantial well positioned company than it was 90 days ago. We have enhanced the value of the company by executing our first 2 commercial licenses and expanding our customer base and engagement count. We bolstered the balance sheet by closing a significant financing that we expect to sustain the company until we achieve cash flow breakeven. The strength of both our IP and know-how portfolios continues to grow.

In the meantime, our engineers have been busy. They're collaborating closely with customers, both in integration and TCAD engineering to maximize results of customer lots across more process nodes than ever. Atomera is delivering compelling solutions to some of the most difficult problems in the semiconductor industry and the technology is available today.

With the challenging conditions in today's capital markets, it's hard to see this. But I want to emphasize that with this level of progress and a very healthy balance sheet, Atomera's intrinsic value is greater than it has ever been before. We look forward to sharing more of our successes with you as we continue to build Atomera into an important and successful technology provider to the semiconductor industry.

Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Cody Acree with Loop Capital.

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

Congratulation on the licensing progress. Frank, you mentioned that this deferred revenue is your recognition of the license fees. And maybe if you can help us, is this the totality of the integration licensing fees? Are there incrementals to come from there before you move to the next phase, the manufacturing phase? And were these licensing fees relatively similar, meaning that you are expect to receive about 37,000 from each or is there more to come in this?

Francis Laurencio ***Atomera Incorporated - CAO & CFO***

Okay. Thanks, Cody. And let me clarify that a little bit because I'll take the first part of, is it 37.5 for each. You have to take into account that one transaction was executed in Q3 and another one was in Q4. So it wouldn't be accurate to take the 75 and break it down. The $75,000 that went on the balance sheet is deferred revenue referred to the Q3 transactions. So this -- then kind of going back to the beginning of your question on whether it's representative of integration license fees or is there more to come before getting to the integration, and -- sorry, the manufacturing and distribution phases. Our list price for in integration license is a $150,000. That being said, there are obviously situations where we will offer discounts to certain customers and we may exchange those for other commitments. But the $150,000 list price is -- to answer the second part of your question, that is the totality of the integrations phase. Scott, I don't know if you wanted to elaborate more on the sort of the overall fees.

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

Yes, thanks. Cody, Let me just say a couple of things there. So obviously we're small and we have only a few of these showing up now over time. It won't be quite as obvious what our -- what we're charging our customers these fees and that will be a confidential piece of the contract we have with them. And we -- there are some technicalities in the way that the revenue is recognized that will make it a little bit -- that may make it more difficult to see as well. But basically that's about the level that Frank had talked about. I mentioned in my remarks that the price for the integration is a small percentage of the overall amount that we talk about for a full license. In the past, we talked about the full license ranging between $1 million and $3 million depending on how it's structured and how much technology we're giving them a license to. But if you think about our list price for license being on the order of $3 million plus or minus, then this first bit would be about 5% manufacturing, would probably represent about 20% and then the distribution piece of the license would represent about 75%.

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

Maybe just, Frank, can you walk me through reason for this, if you signed a deal in Q3, why that revenue wasn't recognized in Q3? Why deferred to Q4?

Francis Laurencio ***Atomera Incorporated - CAO & CFO***

Sure. So the -- there's really nothing more relevant in any -- whether you're under kind of ASC 606 or previous revenue recognition standards as having an established track record of collecting under contracts of a similar type. These being our first 2 license agreements that we've had in the company's history, we felt that actually collecting is a very relevant factor in revenue recognition. Look, the standard as you know looks to completing all performance obligations and one great indication of that is is getting paid. I'll emphasize both ST and AKM have been invoiced, and we've given them very normal payment terms. There is nothing exceptional in those payment terms. But the integration license is for MST work that's done by Atomera. So it is not as straightforward as signing the license agreement and having full access to the rights. So we'll look to delivery of wafers and payment by the customer as the 2 most relevant of those. But as I said, we've invoiced both. We have absolutely no concerns about collection on the invoices to either of those. And you'll begin to be able to see that as you track the deferred revenue and future -- in future bookings of revenue.

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

And lastly, Scott, for me, just as you -- I think you talked about 30 days -- not 30 days, 3 months of integration efforts. Is that the timeline that you expect before we can move these into a manufacturing license so that would put your September around the end of the year, early next year and then you're still in the first quarter probably for the STMicro if that 90 days is your expected time line?

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

Actually, Cody, when I talked about the 3-month period, that was for the -- that was for Phase 4, the manufacturing phase, and then about another 9 months for the qualification phase. We still are not kind of giving a prediction on the timing that it will take to get to the end of the integration phase for these first 2 licenses. Once they get into those -- into Phase 4 and Phase 3, it's much more predictable. But this first part is not as predictable. I can tell you that with both of these guys, and with some of the other customers that we're speaking with, they have internal schedules that they're working towards to before they get through integration and then they get to volume production, after installation and qualification. But even inside those companies, they know that process development is an inherently unpredictable process. And so they have schedules they're trying to meet. But they know that if they have a setback, it can set them back 6 to 9 months at a time. So they don't predict it that tightly either.

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

I'm sorry, just one last thing on. Have they -- have either of these licensees installed a dedicated EPI tool or they're shipping wafers back and forth?

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

Yes. They're still shipping wafers. So, as you know, we have 1 installation, but it isn't either of these 2 licensees. That would be a third company.

Francis Laurencio ***Atomera Incorporated - CAO & CFO***

Yes. And Scott, you just -- that circles back to something I had said an answer to your question. Integration licenses grant rights to integrate MST, but with MST being put on the wafer by Atomera.

Operator

(Operator Instructions) Our next question comes from Suji Desilva with ROTH Capital.

Sujeeva Desilva ***Roth Capital Partners, LLC, Research Division - Senior Research Analyst***

So in terms of the customers you have thus far, I mean [engages rather], you have 11 in Phase 3. Can you just go through the Phase 2, Phase 1 numbers for me?

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

Sure. Yes. I know it's a little unclear to make out on that. Phase 1 has 5 customers right now, Phase 2 has 4, and Phase 3 has 11. I think last quarter, I know we had 2 in Phase 2, so we've added 2 new ones to Phase 2.

Sujeeva Desilva ***Roth Capital Partners, LLC, Research Division - Senior Research Analyst***

That's great. That's what I was looking for there. And then you -- congratulations on having 2 customers in the third quarter here, STMicro and AKM. Can you give us some expectations so we can kind of level set with the frequency with which you get additional customers executing licenses per quarter, just to give us perhaps a range or maybe you would tell us it's hard to provide that kind of range, that kind of color without?

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

Yes. It's a little bit hard to provide that. I can tell you, we're in discussions with -- internally, we have a kind of high priority to lower priority group of people that we're targeting the new sets of licenses. They're all the guys in Phase 3, and there is some that we believe are closer to the point where they're ready to decide to do it and some that are little further away, but we'll continue to be pushing for those. I can't really say, like give you an expectation about how many per month or per quarter. But we're confident that we're going to be getting more of them over time here. It's not something where we only have announced the first 2 that would be possible for the next long period of time, without having more in the bank so to speak. So you can expect us to be announcing more over the course of the next year. No doubt about it.

Sujeeva Desilva ***Roth Capital Partners, LLC, Research Division - Senior Research Analyst***

That's helpful there, Scott. And then something just to kind of feel the (inaudible) back a little bit now. The customers that have taken on multiple nodes per customer, can you just give some color on how that comes about, because it's an interesting kind of divergence from the 1 node per customer that most are doing? I'd be curious on some of the kind of anecdotal discussion around that?

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

Yes. There's a few ways that it's happened. And this is even from when we first started talking with customers, we might typically have our first conversations at the CTO level where they really understand what this technology can do across the entire company, maybe across the foundry or across an [IVM]. And then they say, yes, we could use it in this area and this area and this area. And in earlier days because we were more limited in our resources, we would usually try to talk to them about focusing on one particular area, so we could get a success there. And then later on, we can branch out and do more process now. These days, we are more willing to start out working on multiple nodes with customers right off the back. So we had 1 customer, let's say, we've got 4 that have it right now. And I'd say with 2 of them, we started off as new customers considering doing 2 nodes with them and are now working on that. And with the other 2, they have been working with us on 1 node for a while and then added the second one.

Sujeeva Desilva ***Roth Capital Partners, LLC, Research Division - Senior Research Analyst***

And then lastly, just to understand kind of use the proceeds with the funding here. What's your thought on the EPI tool capacity that you might need going forward 200 millimeter versus 300 millimeter, and plant access outsource versus potentially bring the machine in-house? What's the current kind of thinking calculus on that?

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

Well, today we have a full time 200 millimeter tool in-house. At times, we've needed to expand our capacity on the 200 millimeter to get 2 of those tools simultaneously. And the good news is that we have -- we're working with a partner that has flexibility to allow us to do that. We also go out several times a year and acquire access to a 300 millimeter tool to be able to do customer runs. We don't typically do internal development on 300 millimeter because it's too expensive. But what is definitely happening is that we're getting more customers in 300 millimeter. So when we talk about the potential that we might increase our spending on that next year, it would probably mean that we would take some kind of a lease that gives us a longer term access to the 300 millimeter tool than we've had in the past. Whether it's full time or whether we can figure out a mode where we can get it on an as needed basis just more frequently than we currently do, that's not entirely clear. But I would guess that next year, we'll be spending more money on that.

Operator

Thank you. The conference has now concluded. I'll now turn the call back over to Mr. Bibaud for closing remarks.

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

Thank you all for attending today's presentation. We think our third quarter has been very successful from both the commercial, financial and R&D perspective. 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 call Mike Bishop and we'll be happy to follow up. We look forward to seeing some of you during our scheduled marketing activities including the ROTH Capital Corporate Access Day in New York City in 2 weeks. We thank you for your support and look forward to our next update call in February. Thanks.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Everyone, have a wonderful day.