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ATOM - Q3 2017 Atomera Inc Earnings Call

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Frank Laurencio *Atomera Inc. - CFO*

Scott Bibaud *Atomera Inc. - President and CEO*

CONFERENCE CALL PARTICIPANTS

David Williams *Drexel Hamilton - Analyst*

Scott Reed *Vict10n Capital - Analyst*

PRESENTATION

Operator

Welcome to the Q3 2017 Atomera Incorporated Earnings Conference Call.

(Operator Instructions)

As a reminder, this conference will be recorded.

I now would like to introduce your host for today's conference, Mr. Frank Laurencio. Sir, you may begin your conference.

Frank Laurencio - *Atomera Inc. - CFO*

I'm Frank Laurencio, Atomera's CFO. Joining me on today's call is Scott Bibaud, President and CEO.

In addition to today's prepared comments, we have posted a slide deck to accompany our remarks in the Investor Relations portion of our Web Site at atomera.com. After prepared remarks by Scott and myself, we will open the call up for 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 the Q&A session are subject to inherent risks and uncertainties.

These risks and uncertainties are detailed in the risk factor section of our filings with the Securities and Exchange Commission, specifically in our annual report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 31, 2017.

Except as otherwise required by Federal Securities Laws, Atomera disclaims any obligation to update or make revisions to such forward-looking statements contained here or elsewhere to reflect changes and expectations with regard to those events, conditions and circumstances. Also, please note that during this call, we will be discussing non-GAAP financial measures as defined by the 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 Web Site.

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

Scott Bibaud - *Atomera Inc. - President and CEO*

I want to welcome all of you to Atomera's Third Quarter 2017 Business Update Call.



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I will begin with the progress report highlighting major accomplishments since our last update on August 8. And then, turn it over to Frank, to review our Q3 financial results. We will then open the call for questions.

As an introduction, Atomera is a pre-revenue, materials and intellectual property licensing company with a proprietary transistor enhancement film called Mears Silicon

Technology or MST. We are focused on solving one of the biggest problems facing the \$350 billion semiconductor industry today, the slowdown in Moore's Law.

Using Atomera's technology, a manufacturer can make meaningful power, performance and cost improvements to their chips without requiring the capital investments necessary to support a multibillion dollar move to a next-generation fab. In many cases, customers who have exhausted all other opportunities for significant product enhancement look to MST as the only cost effective solution for getting to the next level.

If a customer elects to work with Atomera, we will execute a license agreement, which grants them the right to manufacture using our technology in exchange for license fee and royalty payments on the shipments of their products.

Slide 4. Because Atomera works with large potential customers who are very secretive, we represent our progress with them using phases of engagement as shown here. Phase 1 includes only customers who are actively planning an evaluation of our technology. In Phase 2, we deposit our technology on customer's wafers for the first time to calibrate our two processes for the next and most important step.

Phase 3 is where customers have traditionally manufactured wafer using our technology and tested the results that justify licensing with us. Of course, this is a complex process since both teams must work closely together to integrate our advanced material into their highly tuned manufacturing flow. Once this wafer run has been completed which may take many months, the customer will see test results giving them enough information for their first licensing decision point.

If they're happy with the results, they can either license with us or run another set of wafers to improve the outcome even more. Indeed, it is our experience that customers quickly transition from a position of evaluating our technology to a point where they are actively working with our engineers to integrate it into their process flow. For that reason, we changed the name of Phase 3 to be called the integration phase.

Slide 5. I'm proud to announce that this quarter we added a 5th new customer to our Phase 3 integration phase. In addition, we're working with all five of our Phase 3 customers to deposit our MST technologies onto their wafers. Today, the work they're doing to integrate our technology with theirs, so then even more significant commitment on their part. Because, the semiconductor industry is running hotter than it has in many years.

Some projections now say that in 2017, semiconductor industry growth will approach 20%. Access to R&D wafers in these fully utilized fabs are getting very difficult to schedule, making them even more precious than ever. It's gratifying to see that our customers continue to allocate these coveted slots to Atomera.

Our phase status update shows the number of customers we have in each phase but I also wanted to emphasize the great headway we're making with some of our Phase 1 customers. Indeed, our engineering work with some of these new customers has progressed to the point where they're planning to run wafers with us but must wait until capacity frees up in their factory.

According to our strict definition of Phase 2, we have not shown them graduating from Phase 1 but hope they will do so soon. As our technology gains a reputation in the industry, we've simultaneously seen strong growth in the companies interested in our technology.

In the last few months, we've reached eight Phase 1 customers, two more than our prior update and recent marketing efforts have also significantly increased the number of new customer account and early engagement but who have not yet reach the criteria to enter Phase 1. We made good progress in diversifying our customer interface to include different market segment and company sizes, reflecting our belief that smaller customers may move faster since their decision process is more streamlined.



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Slide 6. This quarter we announced release of new software from Synopsys which allows customers to evaluate the impact Atomera's technology can have on their semiconductor performance using only software. Dr. Robert Mears, Atomera's CTO, put a very compelling blog posts on our Web Site entitled, How Synopsys' TCAD shows-off Atomera's Magic which explains how Synopsys software can be used to model one specific enhancement called dopant profile engineering.

The two left hand graph on this slide showed measure results from boron diffusion experiments. The blue curve showed boron concentration as originally implanted in the semiconductor and the red curve showed how the concentration changed after being heated. As you can see, the boron is much better retained on the right hand peak when using Atomera's MST technology

This phenomenon is extremely important to semiconductor designers since it allows them to manage implant concentrations across the high temperature cycles used in semiconductor manufacturing leading to higher performance wafers. And the two right hand graphs show how well Synopsys' TCAD software predicts this behavior.

The subject matter maybe a bit esoteric but I can tell you that it is such interest to the industry that Synopsys featured this in their seminars as they went around the world promoting their new TCAD release to hundreds of engineers in the last month.

Imagine that customers can now quantitatively understand how their chips can be improved without having to run these experiments. They only need to use the software. Because of this capability, Atomera is now in discussions with a large number of new potential customers.

Slide 7. Using this capability, Atomera is now actively working with customers to pull their first decision point in by many months using TCAD software. The quick results received in Phase 2 can now be put into TCAD, allowing customers to understand specifically where Atomera technology can give them the most benefit.

And they can make much better estimates of the scale of the improvements, allowing an earlier license decision. Already, we see customers focusing our technology in areas different than their original expectation because TCAD allowed them to redirect in hours rather than waiting for results for months of wafer run.

We have always believed TCAD will help get us through the integration phase more quickly. Now we believe it may help us to get license decision faster as well which is a major enhancement to our customer engagement process that we hope will speed time to revenue.

Finally, let me just say that results obtained from customer trials in the last few months have been excellent. Recent wafer runs conducted by our customers have shown significant improvements in [matching] which lead to smaller die sizes and better yield in electron mobility which enables higher performance chips and in gate leakage which reduces power consumption.

Look for more details coming from Atomera in our blogs as we get new data and permission from some of our lead customers to share it. In a show me industry where customers demand data backing up our claims, these are the type of concrete results which will drive license decisions.

It is, again, worth emphasizing that a single customer going in to high volume production can make Atomera profitable. Today we are well-engaged with 13 customers and our probability of commencing commercialization increases with each new one. Since our IPO, we have more than quadrupled our potential customer base, significantly refined our technology, expanded our IP portfolio, diversified our market focus and solidified partnerships with some of the industry's biggest players.

This quarter has been a story of dramatically expanded customer activity. It's our belief that Atomera is a significantly stronger and better positioned company than we were at our IPO. 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.

I will now turn the call over to Frank for comments on the company's financial results.

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Frank Laurencio - Atomera Inc. - CFO

At the close of the market today, we issued a press release announcing our operating and financial results for the third quarter of 2017. Looking at our results for Q3, our GAAP net loss for the third quarter was \$3.3 million or \$0.27 per share compared to a net loss of \$3.6 million or \$0.30 per share in the second quarter and a net loss of \$4.1 million or \$0.56 per share in the third quarter of 2016.

Looking at our results for Q3 compared to Q2, our net loss decreased by \$346,000 reflecting a \$338,000 decline in operating expenses. This is primarily due to lower stock compensation expense as restricted stock that had been issued at the close of our IPO became fully vested early in August of this year.

Research and development expense in Q3 increased by \$158,000 over to second quarter, primarily due to higher spending and outsourced fabrication and testing to support customer evaluations. General and administrative expense decreased by \$338,000 reflecting the lower stock compensation charges. Sales and marketing expense decreased by \$159,000 in Q3 as compared to Q2, also as a result of lower stock comp expense.

For the third quarter of 2017, our net loss was \$823,000 lower than our net loss in the third quarter of 2016. This decrease was primarily due to a \$1.3 million decrease in interest expense. Partly offset by a \$543,000 increase in operating expenses. Looking at the components of operating expense, general and administrative expense decreased by \$239,000 while R&D expense increased by \$661,000 and sales and marketing expense increased by \$121,000.

The decline in general and administrative expenses was due to bonuses paid in Q3 of 2016 which had been tied to the completion of our IPO. The increases in R&D and sales and marketing were due to increase headcount in both departments as well as higher spending and outsourced fabrication and testing for customer evaluations.

Our IPO closed in August of 2016 in the middle of our third quarter. At that time, all outstanding debt converted to equity and we issued restricted stock and option awards that had been tied to completion of our IPO. As a result, beginning with Q4 of this year our year over year quarterly comparisons will be more meaningful as they will fully -- as they will reflect our operation as a funded, publicly traded and debt-free company.

Slide 8 includes a summary of our financial results for the first three quarters of 2017. This slide also contains a reconciliation between our GAAP and non-GAAP results. As you can see from the slide and from our press release, the main differences between our GAAP and non-GAAP results consist of stock-based compensation and interest expense. Both of which are noncash items.

We believe that non-GAAP adjusted EBITDA, especially when use in conjunction with GAAP information provides a better view for investors and it is what we used for our internal business planning.

Turning to our balance sheet, our cash and cash equivalents at September 30 were \$19.6 million, a decrease of \$2.1 million from the \$21.7 million at June 30, 2017. Our Q3 cash burn was flat as compared to Q2 at \$2.1 million and remains in line with our guidance of approximately \$9 million for the full year. We had no change in our headcount during the third quarter and our outstanding share count of approximately \$12.2 million shares has not change since last quarter.

Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

David Williams from Drexel Hamilton.



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David Williams - *Drexel Hamilton - Analyst*

This is David on today for Cody.

My first question is really around the Synopsys [support] and how meaningful that is. It sounds like you covered it pretty well in the opening remarks.

But I wonder if you could kind of take us through what that means as far as customer evaluation, how that's progressing as part of moving your current customers through the pipeline and kind of what overall that the impact of and significance of that will be for you in the coming several quarters?

Scott Bibaud - *Atomera Inc. - President and CEO*

The Synopsys software does a very comprehensive job at modeling how our technology will improve customer specific processes. As we've explained in prior calls, every manufacturer of wafers builds them a different way. So when we integrate our technology, we have to go through a process with them of figuring out how to best make our technology work with their technology.

And that can take several runs of wafers before we get all that lock in. Now with -- but every manufacturer has a TCAD software that mimics their manufacturing flow. So now that we have our technology integrated into TCAD with Synopsys, we can easily integrate it in with the customers what they called a deck which describes this whole process flow. And get much closer to understanding exactly how we'll integrate with them.

We hope that saves one, maybe even two runs of wafers, each of which can be four to six or more months long. So that definitely we believe will help us to shorten the amount of time it takes us to get to a licensing decision. As I mentioned in the call, another thing that we're seeing happening is interesting and something we didn't expect.

Customers typically tried out our technology and they think they're going to use it in a certain area but what we're finding is that with customers that are putting it into TCAD, they're quickly finding out that it might even worked better in another area. So, they changed their focus and that's happened to us already with at least two customers.

So you know, once they change this focus they get very excited about it. We definitely see higher priority when the customers are excited and so again we hope that will drive us to get to licensing decisions faster.

David Williams - *Drexel Hamilton - Analyst*

Switching gears just a little bit but since the engagement of your foundry test fab partner, have you seen the acceleration of existing evaluations or maybe driving new customer engagements?

Scott Bibaud - *Atomera Inc. - President and CEO*

I wouldn't say that our internal fab partner has driven new engagements but there's no doubt about the fact that it's been very instrumental in helping us with our existing customers. So I mentioned that we -- yes, we have five people that we're running wafers with right now and during the last few months we have initiated putting our technology down on their wafers for each one of those five players.

And on some cases, we've been using our internal foundry to help figure out how best to put our technology down to solve this specific problem they're having. So yes, that's been a big help to us.



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David Williams - *Drexel Hamilton - Analyst*

If you can maybe talk about your liquidity position and your comfort level with where your cash is today and then maybe what your cash burn expectations are as we go through next year?

Frank Laurencio - *Atomera Inc. - CFO*

Yes, we talked about during our last call we had filed a universal shelf registration statement at the one-year anniversary of our IPO when we became eligible to use Form S-3. We ended the quarter with over \$19 million of cash. As I said at the end of my remarks, our cash burn for the full year will be about \$9 million and our planning assumption is that we're not going to increase that materially next year.

We would be looking at absent revenue coming in, having still more than two years of cash on our balance sheet. But to address the S-3 registration as we said it during the last call, we felt it was prudent to take advantage of that tool when it became available to us but not because we have any plans in the near term to raise capital.

That was just something that we did to have that tool available in the future.

Operator

Scott Reed from Vict10n Capital.

Scott Reed - *Vict10n Capital - Analyst*

I just wanted to comment on very high level analysis here. I see that entering Q4 of this year you had the same number or you had doubled the number of customers in Phase 1 versus the level you're at, at the beginning of 2017. And so with that in mind, I was wondering in the last nine months you mentioned some factors that have accelerated the phase of adoption or evaluation by your customers and I was wondering if you think based on that you might say that's over the next nine months we might see customers transition from Phase 1 to Phase 2. Is it safe to say that they might transition at maybe double the rate of what we saw over the previous nine months? And I know this is very forward-looking but just your best estimate on that.

Scott Bibaud - *Atomera Inc. - President and CEO*

I would say there are factors, foreign factors, again Scott, so there's no doubt that we believe use of TCAD will help them transition more quickly. And that's because I mean when we're in Phase 1 with the customer, that means they've signed an NDA, they're sharing details about their highly proprietary process technology with us. And they have a plan to actually go into production.

If we're just talking to someone presales type of things, we don't count them as a Phase 1 customer, they're serious customers. Generally what we're doing in the early days with those customers is helping them to target where our technology can be most helpful to them.

There's no doubt that the Synopsys software will help us do that and will help us do that more quickly and we'll build a lot more credibility inside the customer that we can deliver on what we're saying. And that -- so that should speed them through this process into Phase 2.

Now on the other hand, we're definitely seeing that the industry is so tight right now, that it's hard for our customers to get R&D wafers do their foundry. I'll give you an example, one of our Phase 3 customers, we met with them in August, they're very excited to run some more wafers. They put an urgent request into their production facilities, get those wafers running as soon as possible and we were unable to get a slot inside the factory until this week.



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It's taken them a few months to actually even get that and that's with kind of high urgency. So I said this before, the good news about the industry being really hot, everybody is making a lot of money. When they're making a lot of money, they're thinking about how to enhance their technology for the future because they know the industry goes in cycles.

On the other hand, it makes it harder for us to get wafer starts because the factory is so full.

Scott Reed - *Vict10n Capital - Analyst*

Following on that if we think about an industry that is perhaps facing capacity constraints right now, are people thinking about using a technology like yours to capture more market share as the industry heats up or is everybody reaching such levels of capacity that capturing more market share is not nearly as compelling as it may have been in a down cycle?

Scott Bibaud - *Atomera Inc. - President and CEO*

No, I think people are looking at our technology for a bunch of things. Some people who's factory is full are looking at our technology as a way they can change their process to make the chips smaller and then they would free up more capacity to build more chips I should say because in that case every wafer would hold more chips.

For some players who are looking to get that competitive advantage, they're trying to be the first mover to work with us in a certain process technology. Even at the same geometry as their competitors, they would have higher performance, a lower power. So they're looking at a lot of things and I would say the industry being full, it doesn't change that, it doesn't change that dynamic.

Scott Reed - *Vict10n Capital - Analyst*

Would you say that prior several months that your attitude is changed about what types of semiconductor processes this technology is better suited for or are you still sort of sticking to the line that this would perhaps be additive to just about any semiconductor process at this point.

Scott Bibaud - *Atomera Inc. - President and CEO*

Yes, we still believe it's additive to just about every process out there, and we don't have any reason to change that assumption. I would say though that we see some industries that are more driven to adopt it. We've spoken about it in the past in the slide where we talked about four specific industries where we see feedback from customers saying this is an area that's most compelling to us.

And they were generally fall into the categories of advanced analog where people are trying to get the next-generation analog technology or power out there. People who are doing mainstream fab-like extension, people who are trying to extend the life of a two-dimensional transistor which is around the 28-nanometer and below type of level and that would include memory makers.

And then finally, for people who are looking at [pin sets] or beyond pin sets, this is really the technology development out in the future. They're looking at our -- at our technology as one of many potential things that will help them continue to get improvements in that area. There are some pockets in the middle where we don't see much activity with customers and so that's not places that we're focusing but those are the four major areas that we're focused on now.

Operator

(Operator Instructions)

I'm not showing any further questions in the queue at this time.



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I would now like to turn the call back to management for any further remarks.

Scott Bibaud - *Atomera Inc. - President and CEO*

Thank you for attending today's presentation.

Again, this quarter marked a new high-water mark of customer activity for Atomera which we are hopeful will lead to our first customer commercialization in the near term. Please continue to look for our news, articles and blog posts to keep you up-to-date on our progress. We invite you to sign up for these alerts on our Web Site including new blog posts and investor alerts.

Should you have any additional questions, please call Frank or myself and we'll be happy to follow-up. We look forward to seeing some of you during our scheduled marketing activities, the next of which is the non-deal roadshow in New York with Drexel Hamilton on November 13th and the LD Micro Invitational Conference on December 6 in Los Angeles.

We thank you for your support and look forward to our next update call in February. Thank you.

Operator

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

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