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Q4 2018 Atomera Inc Earnings Call

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Mike Bishop

PRESENTATION

Operator

Good afternoon, and welcome to Atomera Fourth Quarter 2018 Earnings Call. (Operator Instructions) This event is being recorded and it 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, Sonya, and good afternoon, everyone. 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 Frank, we'll 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 Factors section of our filings with the Securities and Exchange Commission, specifically in the prospectus 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 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*

Thank you, Mike. Welcome to our update call, everyone. And I'm glad to have the opportunity to share with you our progress for the last 3 months and to summarize our efforts in 2018. After my remarks, I will turn the call over to Frank for a review of our financial results, and we will open it up to questions.

Atomera is a materials and intellectual property licensing company with a proprietary transistor enhancement film called Mears Silicon Technology, or MST. Our company develops new materials designed to improve the performance of semiconductors and helps our customers integrate them into the manufacturing flow of both existing and new fabs. Our technology can address the slowdown in Moore's Law by providing new materials and techniques to the industry, which will improve performance, lower power and decrease product costs. Atomera is not a manufacturer. We're an IP provider, granting customers the right to manufacture with our technology in exchange for a license fee and royalty payments upon shipments of their products.

Atomera has 3 different sources of revenue: engineering services, license fees and royalties. Customer EPI deposition work as well as integration consulting make up engineering services revenue. In prior years, we had rarely charged for these services, but we expect this revenue will grow as our customer engagements expand. License fees are generated as we sign license agreements with our customers



and as they reach progressive licensing stages that grant them additional rights and trigger further payments to us. Once our customers start production shipments of MST-enhanced products under a distribution license, we will start receiving royalties.

In late Q3, we were happy to announce our first 2 commercial licenses with STMicro and AKM. Now we are happy to report that in Q4, we reached our biggest top line number ever with \$150,000 including our first ever license fee revenue as well as continued engineering services, NRE. Our revenues in Q4, although modest, represent a sustained growth in both licensing and NRE that we hope to continue through 2019.

In the last few months, we've seen several announcements by important industry players talking about the challenges in continuing to follow Moore's Law. At CES, Nvidia's CEO, Jensen Huang, declared that Moore's Law isn't possible anymore. Right now, Moore's Law is only growing a few percentage points a year. He then went on to talk about how material scientists continue to find ways of stretching today's silicon transistor technology. Applied Materials gave an interview in Semiconductor Engineering magazine about unsticking Moore's Law through new material investments. Today, due to the massive expenditures required, only 3 top semiconductor players continue to develop the latest, leading-edge, semiconductor process technology. It is becoming increasingly clear that the rest of the industry needs new material technology to keep advancing the performance curve, especially for high-growth segments like analog, RF, mixed-signal, power and others.

Atomera's MST technology is a proven, available and low-cost technology to provide that boost. Perhaps as a reflection of this trend, Atomera has continued to see very strong interest from both existing and new customers in using our technology to enhance their products. So the last 3 months have been very busy around here.

As a quick overview to our reporting methodology, Atomera represents customer activity with the phases of engagement shown here. Phase 1 includes customers' under NDA who are planning an evaluation of our technology. In Phase 2, we deposit MST film on customers' wafers and conduct physical characterization. Phase 3 is where customers incorporate 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 agreements with customers. In fact, both of our existing licensees are in Phase 3. Phases 4 and 5 are where customers install our technology in their fab, execute both manufacturing and distribution licenses and transition to production.

I am pleased to share with you that during the last 3 months, Atomera has added 1 new customer to our engagement pipeline. Also, 2 customers have progressed from Phase 2 to Phase 3. With these changes, today, we have 21 engagements underway with 17 different customers. 13 of those engagements are in the critical Phase 3 or integration phase, and we continue to have 4 customers working with us simultaneously on multiple nodes or technologies.

According to the SIA, the semiconductor industry is exiting a very strong 2018 with more than 13% growth over 2017, even taking into account a slowdown in Q4, which prevented annual growth figures from being even higher. The expectation is that semiconductor R&D spending will continue to grow in 2019. In prior calls, we've spoken about how the industry's very high demand and capacity utilization were impeding our ability to get R&D wafers run through customer fabs. Although the industry slowdown was starting to become apparent during our last call in November, it had not yet translated into a change in our customer engagements. But in the last 3 months, we have seen a few positive developments from the industry slowdown. First, some of our wafer lots that were in customer fabs have started moving faster than originally forecast, meaning we will get results more quickly. Second, as customarily happens during a slowdown, more customers are coming to us to seek a possible improvement in their product portfolio so our discussions with new customers has expanded. At some point, if this slowdown continues, we may start hearing about tightening R&D budgets, but so far, those messages have not reached our ears or affected our projects. Instead, our customers remain committed to finalizing integration and moving towards licensing and volume production as soon as possible.

Q4 has been a very productive period for Atomera. We continue to generate new IP and solutions for an industry that desperately needs them. This is well illustrated by the strong interest in our December technical seminar as the IEEE's IDM show in San Francisco. We have started discussion with new customers and advanced others to the stage where the likelihood of license execution has increased. Our revenue has begun to grow and diversify. We closed the round of financing in a very difficult market environment, adding solid institutional investors and extending our relationship with many existing ones.



Atomera is executing very well right now, and we believe that this success will translate into additional license agreements across many segments of the rapidly growing semiconductor industry.

Let me turn the call over now to our CFO to discuss 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 full year and fourth quarter of 2018. Our summary financial results are shown here, and I will now review them in more detail.

Our GAAP net loss for the year ended on December 31, 2018, was \$12.9 million or \$1.02 per share compared to a net loss of \$13.1 million or \$1.11 per share in 2017. GAAP operating expenses in 2018 were basically flat compared to 2017.

Revenue increased to \$246,000 in 2018 compared to \$110,000 in 2017. GAAP net loss on a per share basis declined to \$1.02 per share in 2018 from \$1.11, primarily due to an increase in weighted average shares outstanding as well as the lower net loss.

Non-GAAP adjusted EBITDA in 2018 was a loss of \$10.7 million compared to a loss of \$9.1 million in 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 noncash item.

Our GAAP net loss for the fourth quarter of 2018 was \$3.2 million or \$0.22 per share compared to a net loss of \$2.6 million, which was also \$0.22 per share in Q4 of 2017. The main reason for the increase was higher R&D expenses for outsourced engineering and test as we ramped up MST deposition on a growing set of customer wafers as well as for our internal R&D work on MST film. Loss per share was flat as the increase in weighted average shares outstanding offset the higher net loss.

Looking at our results on a sequential quarterly basis, fourth quarter 2018 GAAP net loss was \$3.2 million compared to a GAAP net loss of \$3.4 million in the third quarter of this year. The sequentially lower net loss was primarily due to recognition of \$150,000 of revenue and \$115,000 of gross profit in Q4.

Stock compensation expense was basically flat at \$630,000 in Q4 compared to \$629,000 in Q3.

Non-GAAP adjusted EBITDA loss of \$2.7 million in Q4 compares to a loss of \$2.8 million in Q3 of this year, as our non-GAAP operating expenses decreased slightly due to lower payroll expenses, reflecting lower bonus accrual in Q4 than in Q3.

Turning to the balance sheet. Our cash at December 31, 2018, was \$18.9 million compared to \$17.4 million at the end of 2017 and \$10 million at September 30, 2018. Excluding the \$11.5 million of net proceeds received from our equity financing in October, these cash balances show that we consumed \$9.8 million during the full year of 2018 and \$2.4 million during the fourth quarter.

Our annual cash consumption was consistent with the internal forecast of approximately \$10 million that we made at the start of last year, and which we have shared with you in prior calls.

For 2019, we are planning for operating expenses to increase by between \$1 million and \$2 million as we may need to lease additional EPI deposition tools to support work for customers evaluating MST. This additional work also drives increased spending on metrology.

Lastly, we added 1 headcount in January and expect to slowly add additional headcount, primarily in engineering. Our headcount is now 17 full-time employees.

During Q4, we recognized \$150,000 of revenue, and our deferred revenue balance now stands at \$55,000. As I discussed in our last



quarterly update, under ASC 606, we expect that we will generally recognize revenue from fixed fees in our licenses at the time that the customer gains the right to use our IP, which will either be upon contract execution or when our obligations under the contract have been met. Revenue recognized included both engineering services and license revenue in Q4.

Due to the fact that we are still in the early stages of our revenue ramp and have only had a handful of revenue transactions, our gross margin has been variable, and we expect that it will continue to fluctuate based on our revenue mix.

Engineering services, such as the deposition of MST on customer wafers and related analytical work, result in higher cost of revenue and lower gross margins as compared to license revenues.

Our outstanding share count as of December 31, 2018, was approximately 15 million shares, inclusive of the shares issued in the equity financing that we closed on October 15.

Now 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. While Q4 was very productive for us, let me just take a moment to review how we've progressed in 2018.

At the end of 2017, we were engaged with 14 customers, and today, we have 21, an increase of 50%. More importantly, we've grown our customer count in Phase 3 from 6 to 13, an increase of over 100%. We broke through a significant barrier for the company by executing our first 2 commercial licenses and closed a round of financing which brought on new investors who understand and appreciate our potential. The strength of both our IP and know-how portfolios continue to grow. Indeed, at the end of 2017, we had 160 patents granted and pending, and we now have 198, an increase of 24%.

Our engineers are collaborating closely with customers across more process nodes and technologies than they were a year ago. Atomera is delivering compelling solutions to some of the most difficult problems in the semiconductor industry. Challenges that most players in the industry are struggling with, and unlike other exotic options, the technology is available now. It's very clear that the Atomera of today is far more valuable than at any point in the life of the company. Our years of innovation and investment are starting to pay off. We look forward to sharing more of our successes with you as we continue to build out 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 Suji Desilva of Roth Capital.

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

Scott and Frank, congratulations on the additional license revenue, quite an accomplishment certainly. In terms of the 2 customers you've announced, AKM, STMicro, can you take about maybe, either qualitatively or perhaps even quantitatively, that whether both of them showed up in licensing revenue in the fourth quarter? And if you can't disclose that, qualitatively, how is it progressing there? Where are they in sort of the runs they need to do versus feeling comfortable advancing to the next stage? Any color there would be helpful on these lead customers.

Francis Laurencio *Atomera Incorporated - CAO & CFO*

Yes, Suji. So I'll take one part of the question, which is we did recognize revenue from both customers in the quarter.

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

Yes. The second half is just about progress. So both of these customers, we're working very closely with them. They both have internal schedules that they're working towards to get to manufacturing licenses and production licenses. For a variety of reasons, we still are predicting what those dates will be, and inside those companies, they recognize that there's high variability with the schedules because if they miss one -- if they have to do one additional run, for example than they're currency planning then it can add 6 to 9 months to the schedule. So we're comfortable that we're -- we continue to work very closely with them, that they're making good progress to get where they need to be to move to the next stage of licenses, but we're still not predicting when those will actually be.

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

Okay. Fair enough. And then, Scott, I mean, the -- is it still your estimation that at the point the customers advance out of Phase 3 that the royalties would be a subsequent 4-plus quarters away? Is that still the thinking there in terms of how long that process would take?

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

Yes. Suji, that's still what we believe. Typically, we're very comfortable in knowing that customers will typically enter Phase 4 and be done with Phase 4 in about 3 months. And we're also comfortable that when they enter Phase 5, which is the process qualification, that typically would take about 9 months. Whether the 2 of them would come back to back concurrently, we believe that would be the case. I can see some situations where there might be some delays in that. But generally, we think 4 quarters is probably a good estimate of what we would expect from there.

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

Okay. And then in the prepared remarks, you mentioned an expanding customer pipeline opportunity. I just wanted to clarify, is that beyond the 17 customers you're already engaged with? And more to the point, I guess, as you are pursuing additional customers, do you have the bandwidth of personnel on site to pursue a broadening customer base of opportunities or versus converting existing customers? How is that balance working inside with the people you have?

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

Yes. I'm glad you asked about that because I would say that this past quarter -- so we've been really successful at growing our customer base both in number of customers, number of engagements and also in the different process technologies that we're working on without significantly scaling our internal resources. And I would say, last quarter is the point where we realized that we've started to go a little bit too far. So we added a headcount at the beginning of this quarter, and we will probably be looking at adding 1 or 2 more over the course of this year. I think Frank could talk a little bit about how we may need to add some additional EPI capacity, but we're definitely extremely busy now to the point where it's -- we're basically getting full. So we needed to add a few more resources. All along, I would say, we've been emphasizing moving existing customers forward rather than going out and engaging with new customers. But as I said in my remarks, it's not unusual that when there's a slowdown in the industry, there's more space in our customer fabs to be able to run R&D lots and do R&D worked. Also, people tend to start thinking, okay, if there's a slowdown, how can I differentiate my products to be getting more share. And so they start trying to think a little more creatively. And in the last few months, we definitely have been approached by more customers, and I would say, we've had more interest inbound. And we're not really turning away inbound interest at this point.

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

Right. And one last quick question, perhaps, for Frank. You came pretty close to the \$10 million cash burn estimate you had for '18. Any estimate for '19 you care to put out there given all the moving parts?

Francis Laurencio Atomera Incorporated - CAO & CFO

So the guidance that I gave was really around some increase in the operating expense, give a little more color, it's good transition from what Scott said. One factor, which is a smaller one is adding headcount, and we're really proud of growing the customer base to 50% with a flat headcount last year, but we will add more. The bigger factor though is -- and a bigger component really for us in terms of an increase would be adding additional EPI capacity. Scott talked about things flowing faster in the customer fab as they have more room now for R&D runs. The last thing we want to do is to be the bottleneck and moving customers along. And that's why we are more actively evaluating adding additional EPI tool capacity. And that's why I'm kind of giving a forecast that we could increase our operating expense

\$1 million or even \$2 million this year. I think we've been very careful to not do that too far ahead of seeing revenue coming from that. But I'm not giving a guide for the revenue for the year. So that's why I'm not giving a total cash burn number for the year. But I would expect that the operating expense will increase a bit over last year.

Operator

(Operator Instructions) And our next question comes from Cody Acree of Loop Capital. (Operator Instructions) This conference has now concluded. I will now turn the call over to Mr. Bibaud for any closing remarks.

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

Thanks a lot, all of you, for attending today's presentation. As we discussed, 2018 has been a very successful year from a 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 Conference in Laguna Niguel in March. Thank you for your support and look forward to our next update call in May. Thank you.

Operator

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

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