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MRAM.OQ - Q2 2020 Everspin Technologies Inc Earnings Call

EVENT DATE/TIME: AUGUST 06, 2020 / 9:00PM GMT

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PRESENTATION

Operator

Good afternoon, and welcome to the Everspin Technologies Second Quarter 2020 Financial Results Conference Call. Today's call is being recorded. (Operator Instructions)

At this time, I would like to turn the conference over to Ms. Leanne Sievers, President of Shelton Group Investor Relations, for introductions and the reading of the safe harbor statement. Please go ahead, ma'am.

Leanne K. Sievers - *Shelton Group - President*

Good afternoon, and welcome to Everspin Technologies' Second Quarter 2020 Earnings Conference Call. I'm Leanne Sievers, President of Shelton Group, Everspin's Investor Relations firm. Joining me today are Kevin Conley, Everspin's President and CEO; and Daniel Berenbaum, Chief Financial Officer.

Before we begin the call, I want to remind you that this conference call contains forward-looking statements regarding future events, including, but not limited to, our expectations for Everspin's future business, financial performance and goals, customer and industry adoption of MRAM technology, successfully bringing to market and manufacturing products in Everspin's design pipeline and executing on its business plan. These forward-looking statements are based on estimates, judgments, current trends and market conditions and involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements.

We would encourage you to review our SEC filings, including the Form 10-Q filed with the SEC on May 8, 2020, and other SEC filings made from time to time in which we may discuss risk factors associated with investing in Everspin. All forward-looking statements are made as of the date of this call, and except as required by law, we do not intend to update that information. Additionally, the company's press release and management statements during this conference call will include discussions of certain measures and financial information in GAAP and non-GAAP terms. Included in the company's press release are definitions and reconciliations of GAAP to non-GAAP items as well as GAAP net loss to adjusted EBITDA, which provide additional details. This conference call will be available for audio replay for at least 90 days in the Investor Relations section of Everspin's website at www.everspin.com.

And now I'd like to turn the call over to Everspin's President and CEO, Kevin Conley. Kevin, please go ahead.

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

Thank you, Leanne. Good afternoon, everyone, and thanks for joining our call today. We're pleased to report that in the second quarter, we delivered our fourth sequential quarter of revenue growth, accompanied by a strong improvement in bottom line results. Through strong cost containment and execution, we delivered results at the high end of our EPS guidance, demonstrating progress toward our goal of profitability driven by MRAM sales.

A key milestone we achieved this quarter was our first positive pro forma EBITDA. Key elements of this result are a ramp of the industry's first 1 gigabit STT-MRAM product, supported by our expanded portfolio of Toggle products, further demonstrating Everspin's leadership of the MRAM market.

Throughout the second quarter, our operations team achieved strong results while executing under the more restrictive operating protocols we put in place in response to the COVID-19 pandemic. These precautionary measures, designed to keep employees safe and assure operational continuity in the COVID-19 environment, have allowed us to supply customers without disruption and to progress on our business improvement initiatives. We continue to actively monitor conditions caused by the pandemic in all geographies in which we operate. And in cooperation with our partners worldwide, we are confident in our ability to maintain consistent delivery to our customers of high-quality product that is critical for their applications.

In parallel, we are working to further improve our overall operating performance. Our second quarter results were fueled primarily by strong demand across our customers that supply to server and storage applications in the data center market. Demand for MRAM utilized in RAID controllers for servers and into storage arrays reaching -- reached an all-time high, and our operations team was able to execute and to meet the surge in demand with record product shipments.

In addition, we saw a strong increase in our sales for gaming applications as well as sustained demand in the Industrial Automation segment. These areas of strength were partially offset by increasing softness in other industrial market segments, such as retail point-of-sale systems and transportation, which includes aviation, smart transportation infrastructure and some automotive. Another contributor to our Q2 revenue and a notable achievement was the start of mass production shipments of our 32 megabit Toggle MRAM product to a growing set of end customers. We are proud of our product development and operations team in this achievement and are pleased with the level of acceptance it's receiving from some of our key industrial customers. We expect to broaden this product line with different package and temperature grade options throughout Q3 to expand the opportunity with a broader set of customer applications.

Additionally, our second key design win for our 1-gigabit STT-MRAM product that we recognized in Q1 is currently scheduled to start production shipments in Q3 into a persistent memory application for an OEM customer that sells into the data center segment. This is an important emerging solutions space being driven by big data analytics on large databases, and we are excited that the high-performance persistence of MRAM has achieved this early adoption.

In terms of forward-looking market dynamics, the main unknown factor is the pace at which customers will progress in qualifying new products and launch into their markets during a time when they're dealing with unprecedented levels of economic uncertainty. One silver lining that we see is that we believe that the pandemic has caused a meaningful acceleration in the digital workplace. This portends continued memory and storage demand from our customers that supply to data centers, although we may see fluctuations in shipment timing due to adjustments in inventory level, which I'll touch upon shortly.

Additionally, as factories resume manufacturing operations under compressed worker shifts and social distancing, we expect factory automation to become increasingly important and experience long-term growth. We believe commercial aviation segment will have longer-term challenges recovering to historical levels, but aerospace more broadly remains strong. We also expect medical devices spending to resume growth after focus on managing the COVID-19 emergency subsides.

At the end of Q2, we saw some drift upward in customer and distributor weeks of inventory, but they remained within healthy levels. We believe this is in part due to customer concerns about supply chain disruption, but could also indicate a change in consumption rates. As a result of data center market demand fluctuations and our views of inventory levels, you will see that we are guiding conservatively on revenue in Q3. That said, those customer and channel inventory levels are at lower levels than what we saw at the end of Q2 2019. And we ended Q2 with our own internal inventory in terms of weeks of supply at the lowest level they have been in the last 4 years.

While these demand dynamics we are seeing align to the macro environment we see worldwide, we're increasing our market reach with new design wins and an expanding customer base. In fact, we had expected COVID-19 conditions to cause delays in securing new design wins in the quarter when in reality we saw the number of design wins increased by 16% in Q2 over Q1, which is also more than 3x the number of design wins in Q2 last year. This clearly highlights that the market demand remains strong for our MRAM products even in the midst of this current environment. Against this challenging economic backdrop, we remain focused on improving our market position so that as the market recovers, we will be well positioned to accelerate growth.

It is now my great pleasure to introduce Everspin's newly appointed Chief Financial Officer, Dan Berenbaum, who will take you through our second quarter financial results and third quarter guidance. Dan?

Daniel A. Berenbaum - *Everspin Technologies, Inc. - CFO & Principal Accounting Officer*

Thank you, Kevin, and good afternoon, everyone. I'm very excited to be here with Everspin. As some of you on the call may know, I spent a long time in semiconductors, both in the industry and covering stocks on Wall Street. I've been able to observe Everspin for a while now from the outside. I'm a strong believer in the value proposition of MRAM and more specifically in Everspin's technology leadership. I'm also looking forward to reconnecting with many of you that I've worked with in the past as well as getting to know a number of new names.

I would also like to thank Matt Tenorio for his outstanding work as interim CFO and for his support during this transition. Matt, along with the entire Everspin finance team, deserve a tremendous amount of credit for the great work that they've done over the past half year.

With that, let me move to the second quarter financial overview. I'll focus my discussion on non-GAAP financial results. Please look at today's press release for a detailed description of our GAAP results as well as a reconciliation of GAAP to non-GAAP results. Our non-GAAP adjustments this quarter are primarily to exclude stock-based compensation.

Revenue in the second quarter of 2020 was $11.8 million, a 17% sequential increase compared to the $10.1 million in the first quarter of 2020 and a 37% year-over-year increase from $8.6 million in the second quarter of 2019. MRAM product sales in the second quarter, which includes both Toggle and STT-MRAM, was $10.9 million compared to $9.6 million in Q1 and $8 million in the second quarter of 2019. The strong growth in product sales reflects record revenue contribution from our STT-MRAM products as well as continued growth of our Toggle products. Licensing, royalties and other revenue in the quarter contributed $0.9 million compared to $0.5 million in the prior quarter and $0.6 million in the second quarter of 2019.

Gross profit for the second quarter of 2020 was $5.2 million or 43.9% of revenue compared to $5.4 million or 52.9% of revenue in the prior quarter and $4 million or 46.5% of revenue in the second quarter of 2019.

As mentioned on last quarter's earnings call, meeting our cost targets for our 1 gig STT-MRAM product has been more challenging than expected, due in part to the work-from-home environment and travel constraints associated with the pandemic. This has put downward pressure on margins. However, we expect our product costs to improve sequentially in the second half of 2020 and continue to improve into 2021.

Non-GAAP operating expenses for the second quarter of 2020 decreased to $5.4 million from $6.2 million in the previous quarter and $6.8 million in the second quarter of 2019. Non-GAAP R&D expense was $2.6 million compared to $2.9 million last quarter and $3.4 million in the same quarter a year ago. Non-GAAP SG&A was $2.8 million compared to $3.3 million in the prior quarter and $3.5 million in the second quarter of 2019. The decrease in operating expenses reflects the expected benefit of the cost reduction initiatives that we initiated at the beginning of the year.

Please note our GAAP R&D and SG&A expenses and stock-based compensation excluded from those amounts can be found in our press release from today. Interest expense for the second quarter of 2020 was $172,000, flat from Q1 and down from $186,000 in the second quarter of 2019. Other income in the second quarter was a negative $35,000 compared to positive $22,000 last quarter and a positive $111,000 during the same quarter a year ago.

Non-GAAP net loss for the second quarter of 2020 was $0.4 million or a loss of $0.02 per share based on 18.7 million weighted average shares outstanding. This compares with a net loss of $1.0 million or $0.05 per share in the prior quarter and a net loss of $2.9 million or $0.17 per share during the same quarter a year ago. The significant improvement in year-over-year bottom line results underscores the continuing benefits from growth in our STT-MRAM products, combined with the expense reduction initiatives and ongoing cost reductions in our mature product lines.

Adjusted EBITDA for the second quarter of 2020 was a positive $0.2 million compared to a negative $0.3 million in the prior quarter and a negative $2.2 million in the second quarter of 2019. This is the first positive pro forma EBITDA in the history of the company, an important milestone on our journey to sustained cash generation.

Now turning to the balance sheet. Cash and cash equivalents were $12.9 million at the end of the second quarter compared to $14 million at the end of the prior quarter. Cash used for operations plus CapEx was $1.9 million in the second quarter compared to $2.6 million last quarter and $1.9 million in the second quarter of last year.

In July 2020, we restructured our loan with Silicon Valley Bank to reduce interest rates and extend the interest-only period. As a result, the interest-only period has been extended through 2020, and cash used for debt service in 2020 will be reduced by approximately $0.8 million. The reduction in debt service costs is a key component of our strategy to preserve cash and provide the necessary resources for the company to continue driving sustainable growth.

At the end of the quarter, we had a balance of $2 million on our $5 million line of credit. We continue to believe we have sufficient cash to support our operations and growth objectives.

Total assets at the end of the second quarter were $35.1 million compared to $34.7 million at the end of the prior quarter. Total liabilities were $14.7 million in the second quarter as compared to $14.7 million at the end of the first quarter of 2020. Stockholders' equity was $20.4 million compared to $20.0 million at the end of the first quarter of 2020.

Turning to our third quarter guidance. We expect revenue to be in a range of $10 million to $10.8 million. We expect a GAAP loss per share of between $0.11 and $0.05, and on a non-GAAP basis, a range of a loss of $0.06 per share to breakeven.

As Kevin mentioned, we believe we are seeing a period of inventory digestion, particularly in some of our end markets that are served through distribution. We're confident that long-term demand for industrial, IOT, automotive and other markets that we serve through distribution remain healthy, but we are likely to continue to see swings related to supply chain disruptions related to the pandemic.

We are also confident in the growth trajectory of our data center products though there as well, we expect near-term demand could be a bit lumpy. We remain focused on funding our critical R&D programs, while at the same time, executing on operational improvements and rigorous cost discipline. Operator, you may now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Raji Gill from Needham & Company.

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst*

Welcome, Daniel. A couple of questions. One on the gross margin for 2Q. The big drop to 43.9%. You talked about kind of product costs related to STT-MRAM. Wondering if you could kind of go into detail in terms of why are the product costs so high? Why are they larger than anticipated? You talked about kind of working from home, having an impact, but that seems kind of odd. But maybe you could explain the product costs being high. And just on the guidance, the sequential decline in the guidance for third quarter, maybe you could elaborate a little bit further when you're talking about an inventory digestion via the distribution in certain end markets. What end markets are those? What's the inventory situation in the channel? And when do you expect that to be cleared?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

Raji, just to clarify, when we're -- the commentary from last quarter's call, we explained that we're seeing a pretty strong demand as we're ramping the 1 gig product. And the issue was progress on that ramp from a cost perspective and the crimp, normally, the engineering teams will be working together in the same location. So we talked about the impact on -- or the anticipated impact of the restricted environment there on slowing that down. So I hope that kind of explains what we had commented on relative to the 1 gig. But for the other commentary on how that's fitting into the gross margins we just presented as well as the second half of the year question, I'll hand it off to Dan.

Daniel A. Berenbaum - *Everspin Technologies, Inc. - CFO & Principal Accounting Officer*

I think, Kevin, I think you pretty much covered it. I mean, Raji, you simply are -- I think this was mostly covered, not a lot of surprises from what had been discussed in the prior call, things were just a bit slower on the gross margin front on the cost improvement side than we had hoped that they would be. That said, we are executing to pretty aggressive plans there. So we do expect to see gross margins move up because of those cost improvements on both the STT and Toggle side in Q3.

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst*

Yes. And then my question on the revenue guidance.

Daniel A. Berenbaum - *Everspin Technologies, Inc. - CFO & Principal Accounting Officer*

So on the revenue. Yes. We talked about a period...

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst*

Sorry. Could you elaborate further on the inventory digestion, which end markets? Why is this happening? When -- how long are the -- how much inventory is in the channel, et cetera? Those are kind of bigger questions.

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

So Raji, I think the -- we talked about, again, some indication in terms of current levels that we see drifting up towards the higher end of what we consider a normal range of 6 to 10 weeks of supply. That said, it's still within that normal range. And that having an impact on turns business. So that's kind of a signal that we're looking at there. Again, not something that we are panicked about, but is something that we have to be conscious of as we look at the next quarter. Specifically, we have seen a lot of other market commentary, and we hear it from our customers as well in terms of the pace at which demand is slowing up to our customers from data center segment, which is pretty significant. And as Dan talked about in his -- I like his term, lumpy, that he used in terms of how that comes in. So those are the main factors that we're looking at that are driving us to be more conservative in terms of that outlook than you might otherwise expect.

Daniel A. Berenbaum - *Everspin Technologies, Inc. - CFO & Principal Accounting Officer*

I will also call out. I mean MRAM product sales -- product sales in the quarter were up pretty significantly year-over-year. So that was a very strong quarter, a period of a little bit of digestion after a quarter like that. I don't think that's very surprising, particularly given the uncertainty that we see in the world now.

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Operator

Your next question comes from the line of Richard Shannon from Craig-Hallum.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Welcome, Daniel. Looking forward to working with you. I guess maybe a tactical question here on the guidance for the third quarter. If I'm trying to run some numbers here and taking Daniel's comments on OpEx into account. It seems like the gross margin that you're implying here would probably get into the 50-plus percent range. Is that a fair interpretation of what you're intending here?

Daniel A. Berenbaum - *Everspin Technologies, Inc. - CFO & Principal Accounting Officer*

So Richard, we're not going to guide gross margin specifically. All I can say is that with the comments that we made or we do expect gross margin to improve as we execute on our cost reduction projects. And we do intend to maintain tight control over both cash flow and operating expenses.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. Fair enough. Regarding the inventory digestion, I apologize, I got on the call just a little bit late, so I may have missed some comments. But is the digestion here just through distribution and customers served through distribution? Or is there an inventory burn for direct customers as well?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

So as I mentioned, Richard, it's a combination of customer and channel inventories.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. And to my -- if I caught the comments, Kevin, that you gave us across a number of industries here or sectors, including data center and parts of industrial and automotive? Did I catch that right? Or are there other specific industries you called out?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

No, that's correct. Those are the main ones.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. That is helpful then. Let's see here. I had one other question -- or a couple of other questions here. In your prepared remarks, you've talked about the 32 meg Toggle product, which I think you announced a few quarters ago. How should we think about the scale of benefit here that we should see over time? How big can this be relative to your current Toggle business? If you can give us some sense? And also maybe end markets where you're seeing initial traction.

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

It's hard for me to give you a precise answer on that, Richard. But as we have talked about, we released that product in response to what we saw as pent-up demand for higher capacity products in our Toggle portfolio. And that's part of -- normally as we see more integration of data sources such as sensors and more compute to consume those data, the need for more memory is going up. So we do think that it gives us, number one, a potential to ride that wave of demand and allow customers to do it without impacting their form factors, et cetera, which is actually unique relative to the competitive technologies that we sell against. So we do think it's a good opportunity there, but it's hard for me to help you out with a specific number on that.

Richard Cutts Shannon - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. That's fair enough. My last question, I'll jump out of the line. And maybe a follow-up on Raji's questions of the nature here. Would you expect this inventory burn to be largely over in the third quarter? And certainly, given all the positive comments we've heard from me for a few quarters in a row about very strong design win progress, would you expect the fourth quarter to be directionally up in sales?

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

What I would say is that we're certainly going to be working to prepare for stronger demand coming out of Q3 and laying the groundwork there, should it appear. It is hard for me to give you much color beyond Q3 in the current environment, Richard. But certainly, we do think there are some areas of our business that have the potential to drive growth in the fourth quarter.

Operator

I am showing no further questions at this time. I would like to turn the conference back to Mr. Kevin Conley.

Kevin Conley - *Everspin Technologies, Inc. - CEO, President & Director*

Thank you, operator. In closing, I'd like to thank the entire Everspin team and partners in creating a sustainable new normal for operational excellence. Our customers can continue to rely on supply of world-class quality MRAM products to meet their needs because of these efforts. Our progress in strengthening our business is clearly visible even under the current adverse market conditions and we will work to continue to successfully deliver on our objectives. Most important of these objectives is to achieve cash flow breakeven this year, while we execute on our long-term growth strategy.

Before we go, I want to inform investors that we'll be scheduling virtual investor meetings with Oppenheimer on August 20. We're also participating virtually at the Jefferies Annual Semiconductor Conference on September 1 and 2. For those interested in scheduling a meeting, please contact the Shelton Group or the hosting firm. We look forward to reporting our progress and business results on our call next quarter.

Thank you for joining us today. Operator, you may now disconnect the call.

Operator

Ladies and gentlemen, that concludes today's conference call. Thank you for participating. You may now disconnect.

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