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Q3 2019 Everspin Technologies Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Everspin Technologies Third Quarter 2019 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the conference over to your host, Ms. Leanne Sievers, President of Shelton Group, Investor Relations. Please go ahead.

Leanne K. Sievers ***Shelton Group - President***

Good afternoon, and welcome to Everspin Technologies Third Quarter 2019 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, Jeff Winzeler, 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 2018 Form 10-K filed with the SEC on March 15, 2019, and other SEC filings made from time to time in which we may discuss risk factors associated with investing in Everson.

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 this information. This conference call will be available for audio replay for at least 90 days in the Investor Relations section of Everson 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, and good afternoon to those joining us on today's call. The third quarter marked another period of solid execution by the Everspin team and was further supported by other positive developments across our business. We achieved record STT-MRAM product revenue and sequential Toggle MRAM revenue growth over Q2.

Operations delivered well to its key objectives on product delivery and cost reduction. Additionally, we recently expanded our product road map, signed another meaningful patent license and have line of sight to increasing royalty revenue next year. These positive developments are happening against a backdrop of signs of recovery for many of our key markets and demand drivers.

Leading MRAM growth this quarter were components sold into the data center segment as a function of the rising number of new server builds, coupled with continued strong demand on the storage side. We saw meaningful increases in RAID controller card builds in enterprise server applications, which benefits our Toggle products as well as continued progress in storage arrays for our STT-MRAM products. We expect this trend to continue throughout year-end and as we enter 2020.

More broadly, we have also seen demand from industrial applications starting to show modest recovery in most geographies. This trend coupled with increasing distributor restocking is a positive indicator in a segment that was significantly challenged in the first 2 quarters of this year. As an early indication of further recovery, in Q3 we secured nearly 60% more design wins than in Q2 for our Toggle products, giving further indication of longer-term growth potential for these products. The recent resolution of the trade conflict at the core of the previously discussed China factory automation segment challenges, seems finally at hand and may bring relief as the sector recovers. Although certain challenges still exist in some of these areas, the current overall trend seems to be positive, as indicated by an increase in the number of customers ordering as well as continued healthy distributor inventory levels.

With regard to our operations this past quarter, production yields continued to increase based upon the strong work being done by our operations team and some of our manufacturing partners. Other optimizations in our supply chain have also helped lower our manufacturing costs. These efforts across our entire supply chain will be an ongoing area of focus as we strive to improve our production costs, increase our competitiveness and support a healthy bottom line.

Our third quarter revenue results included our strongest STT-MRAM quarter-to-date, driven by shipments of both our 256-megabit and 1-gigabit products. Notably, the bring-up of our 1-gigabit product has met our internal technical maturity milestones and exceeded production yield ramp targets for the quarter. We continue to work toward qualification in the programs presented by IBM at Flash Memory Summit as well as engage with new customers for this groundbreaking product.

Additionally, we continue to work with Ecosystem partners, including the enterprise storage controller companies announced at FMS, as well as others, to cultivate a broader set of customers in the data center segment. Now I'd like to take a moment to discuss an important new development in our MRAM product road map. In August, we announced that our 28-nanometer STT-MRAM technology competed -- completed qualification, achieving 10-year data retention and extended operating temperature capability, both major improvements over our 40-nanometer technology. The significance of these characteristics is that we can now address opportunities outside the data center market. Based upon this development, we're excited to announce an extension to our memory road map that will engage our existing customers in the broad Industrial IoT segments with a new set of STT-MRAM solutions using standard interfaces and packages.

This will further enable our existing customer base to easily integrate MRAM's unmatched advantages into applications that need higher density in a much more economical way than today's solutions. Combined with our STT-MRAM efforts in data center applications, we are focused on expanding the market opportunity for this game changing technology.

Shifting to recent developments related to our Toggle product line, we announced our new 32-megabit Toggle product last week that has already started sampling to several leading customers across multiple market segments. These customers are eager to test the highest density Toggle MRAM we have ever produced. This new product will allow systems to employ more memory in a smaller footprint and can reduce system costs, which are important design considerations in these segments. In addition to the 32-megabit part, we also expanded our Toggle MRAM roadmap to include 8-megabit and 2-megabit densities, addressing gaps in our current memory offerings, while providing more affordable solutions for certain customers with lower cost and density requirements. With customer qualification starting now, we believe we will begin to recognize new product revenue in the second half of 2020 and beyond.

Another highlight during the quarter was our announcement of a patent cross-licensing agreement with Seagate Technologies. This agreement is further indication of the strength of our patent portfolio. Everspin has granted Seagate a license to patents covering TMR sensors for HDD applications.

In turn, Seagate has transferred a number of early STT-MRAM patents to Everspin and granted a license to its remaining MRAM patent portfolio. We believe this is strong validation of our IP portfolio and that the gain of these patents, which complements our already strong family of MRAM patents, is another significant step in further strengthening our IP position.

And finally, in the GLOBALFOUNDRIES Technology Conference held last month, GF quantified that the portion of its 22-nanometer FDX product pipeline that includes embedded MRAM or eMRAM, is valued at over $500 million in revenue potential. Their public commentary on productization remains consistent that shipments of 22-nanometer FDX eMRAM-based products should start next year. This is another positive indication that the royalty stream from our license to GLOBALFOUNDRIES for their embedded MRAM program has the potential to result in a meaningful revenue ramp commensurate with their product shipments.

In summary, it's been another productive quarter further underscored by solid operational execution and tight expense control, resulting in significantly lower cash consumption. Additionally, we're seeing increasing demand driven by improving market conditions, have growing customer interest in our current and expanded MRAM product portfolio, and have improved line of sight to meaningful royalty revenues. And, we made good progress strengthening our IP portfolio. Collectively, these developments demonstrate our continued progress towards sustainable growth as we leverage our leadership position in the MRAM market and drive future growth for Everspin.

For more detail on how this is playing out on our numbers, Jeff will now take you through third quarter financials and fourth quarter guidance.

Jeffrey G. Winzeler ***Everspin Technologies, Inc. - CFO & Secretary***

Thank you, Kevin, and good afternoon, everyone. I'll start by reviewing the third quarter 2019 income statement. Revenue in the quarter was above the high-end of our guidance at $9.2 million and compared to $11.5 million in the third quarter of 2018 and revenue of $8.6 million in the second quarter of 2019. Looking specifically at MRAM product sales in the third quarter, which includes Toggle and STT-MRAM, revenue was $8.4 million compared to $10.4 million in the third quarter of 2018 and $7.9 million in the previous quarter. The sequential increase in MRAM product revenue reflected growth of both Toggle and STT-MRAM revenues. Licensing, royalties and other revenue in the third quarter of 2019 contributed approximately $808,000 compared to approximately $1 million in the third quarter of 2018 and $600,000 in the previous quarter.

Gross profit for the third quarter 2019 was $4.4 million or 47.4% of revenue compared to $5.4 million or 47% of revenue in the third quarter of 2018, and compared to $4 million or 46.5% of revenue in the prior quarter. During the quarter, we continued to see the yields necessary to hit our target margins on Toggle products. This was somewhat offset by the cost penalty of underutilization of our 200-millimeter fab.

Operating expenses for the third quarter of 2019 were $7.9 million compared to $10.9 million in the third quarter of 2018 and $7.6 million in the previous quarter. Breaking down our operating spend for the third quarter, research and development expenses were $3.4 million compared to $6.5 million in the same quarter a year ago and $3.5 million last quarter. SG&A expenses were $4.5 million compared to $4.5 million in the third quarter of 2018 and $4.1 million in the prior quarter. We remain focused on tight spending controls, as evidenced by the $3 million reduction in OpEx year-over-year.

GAAP net loss for the third quarter 2019 was $3.7 million or $0.21 loss per share, based on 17.3 million weighted average shares outstanding. This compared with the GAAP net loss of $5.6 million or $0.33 loss per share during the same quarter a year ago and a loss of $3.7 million or $0.21 loss per share in the prior quarter. On an EBITDA basis, the loss for the third quarter was $2.2 million compared to $4.1 million in the third quarter of 2018 and $2.2 million in the previous quarter.

Now turning to the balance sheet. Cash and cash equivalents were $14.8 million at the end of the third quarter, a reduction of $493,000 from the $15.3 million at the end of the second quarter of 2019. More specifically, cash used for operations plus capital expenditures was $770,000 compared to $1.8 million last quarter and $3.5 million in the third quarter of last year. During the third quarter, we raised $2.2 million from the issuance of new stock through our ATM facility that was put in place in August. These funds enabled us to pay down debt principal and refinance the remaining balance on our loan with Silicon Valley Bank, an agreement that we announced in August of this year.

As a result of this refinancing, cash used for debt service will significantly decline from approximately $1.7 million per quarter to an interest-only payment of approximately $200,000 per quarter through mid-year 2020 on the $8 million remaining loan balance. The combined reductions in cash used for operations and debt service costs are key components of our strategy to preserve cash on the balance sheet and provide the necessary resources for the company to continue driving sustainable growth.

Total assets at the end of the third quarter were $35.1 million compared to $37.5 million in the previous quarter. Total liabilities were $17.1 million in the third quarter as compared to $18.8 million in the second quarter of 2019. Stockholders' equity was $18.1 million compared to $18.6 million in the second quarter of 2019.

Looking at our guidance for the fourth quarter, we expect continued growth with revenue increasing to a range between $9.3 million and $9.7 million. GAAP loss per share is anticipated to range between $0.18 loss per share and a $0.14 loss per share, based on an average weighted share count of 17.4 million shares outstanding.

With that, operator, you may now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Richard Shannon with Craig-Hallum.

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

Kevin, one of the more interesting comments from your prepared remarks regarding your STT products that are now -- now have a 10-year retention. It seems like a pretty significant opportunity here. Maybe if you can give us a sense of where you're seeing interest? How long would the design cycles be? And when might you start to see an effect of those products in terms of revenues?

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

Sure. Thanks, Richard for the question. So, going from the data center requirement of 3 months data retention to 10 years opens up a host of industrial and IoT applications that I referred to, many of which we are servicing in lower densities with our Toggle products. So the opportunity -- we see that expanding the opportunity for us pretty significantly. We would expect our target for production of these products is in the 2021 time frame. So, we would expect to see revenues after qualification of products that we would be sampling customers at that time.

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

Okay. Are these displacing Toggle sockets or in addition to some -- in addition to the socket security?

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

These are in addition. So our Toggle products, they top out with our newest announced product, the 32-megabit. They top out at 32-megabit. So these will be 64-megabit and upward.

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

64 Mb. What is the high-end of the density range you're expecting for that 10-year retention?

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

These would be up to 256-megabit.

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

256. Okay. Excellent. Kevin, maybe you can discuss the progress you're seeing here with 1-gig engagements, qualifications, et cetera. Obviously, we've seen 2 customers that you've announced so far. Maybe you can describe the progress in the last quarter? And again, maybe describe the pipeline here relative to what it looked like with the 256 at a similar stage of development?

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

As I said in the prepared remarks on the yield ramp, we've been ahead of our targets, which were more or less in line with what we saw on the 256-megabit. And I think we're about on similar, if not ahead of qualification milestones from what we experienced with our 256 Mb. So things are looking pretty good.

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

Okay. Let's see here. Maybe one more question, and I will jump out of line here. I think one of the opportunities you've talked about a lot this year regarded that 1-gig market expansion once you see ASIC controllers should the SSD market start to support MRAM. And I think there were, I think you've, Kevin, if you've announced 1 or more than 1 partner so far, but I think you're expecting some more at some point during this year or next. I wonder if you can give us an update on the progress there and when do you expect that market to really help the 1-gig product line inflect in terms of sales?

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

Yes. So we announced 2 partners in August, Sage and Phison and there are 2 others that we haven't yet named publicly. Engagement with all 4 companies continues. And again, those controllers would be expected to be released to their customers in the 2020 time frame. And therefore, we would expect -- we wouldn't expect to see products using those controllers before the 2021 time frame.

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

Okay. Okay. Actually, maybe I'll ask another quick question here for Jeff on the numbers side here. I think last quarter, you talked about your OpEx levels kind of coming down nicely, which is great to see, and then it would kind of level off there. Is that a safe assumption as we try to model your December quarter guidance to try to reach the bottom line number you gave?

Jeffrey G. Winzeler ***Everspin Technologies, Inc. - CFO & Secretary***

Yes. So our OpEx has come down. In Q2, we reported $7.6 million total and this quarter $7.9 million. We've reached a level of OpEx, as I've talked about in the past, where we really feel we can service the business going forward. We're continuing to look at additional opportunities to reduce that number. But from an OpEx budgetary perspective, I think the last couple of quarters are pretty indicative of what we expect to spend.

Operator

Your next question comes from the line of Ari Shusterman with Needham & Company.

Ariel Jonathan Shusterman ***Needham & Company, LLC, Research Division - Associate***

Taking this question for Raji Gill. So I want to first talk about the factory automation application of Toggle. So I recall, last quarter, it was impacted by some softness in China. And I think you said in your prepared remarks, there has been a bit of recovery. So can you kind of talk about, kind of, the impact you're seeing from macro on your Toggle business, STT-MRAM business as you head into the next quarter? Yes, any signs of softness?

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

Thanks for the question, Ari. To clarify the comment. The comment was that the challenges that we had seen in the demand to our end customers was from supply chain redesign that resulted as a function of the international trade dispute. Now that those disputes have been resolved. This is, we think, a positive indication for -- that will allow that segment to recover. To date, we haven't seen that. There's still challenges in terms of the amount of demand we're seeing there. But at least this clears the way for that segment to recover.

Ariel Jonathan Shusterman ***Needham & Company, LLC, Research Division - Associate***

Got you. That makes sense. And other applications and can -- actually, can you break up Toggle into the biggest applications or like what percent of Toggle, would you say roughly is factory automation as compared to data centers, et cetera?

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

Yes, Ari. We don't break those into specific buckets, needless to say that factory automation is one that we highlight quite frequently as one of the major applications as our rate controllers for data center servers. And we highlight a lot of these top segments in our earnings deck, but we don't provide direct guidance in terms of precise percentages on those.

Ariel Jonathan Shusterman ***Needham & Company, LLC, Research Division - Associate***

Okay. I guess switching gears a bit. As we go to gross margins. Can you talk about some puts and takes, and how we can think about gross margins trending, I guess? As we enter into Q4 in 2020, what is your gross margin target at the moment?

Jeffrey G. Winzeler ***Everspin Technologies, Inc. - CFO & Secretary***

Yes, Ari, as I said in my prepared remarks, the key component for us from a gross margin perspective, like most semiconductor companies is product yield, and we've been very happy that our yields are at a point where we can achieve the target margins that we have in the business of 50% plus. So that's good. I also talked about the fact that we had -- we've talked about our Toggle business being down because of these macroeconomic factors, and that has put a tax on the product cost associated with manufacturing Toggle products. So, I think as we see recovery and as we see increased volume for Toggle, we would expect that gross margin to trend up.

Ariel Jonathan Shusterman ***Needham & Company, LLC, Research Division - Associate***

Right. Yes, that makes sense. And just one more question. As it relates to your Toggle opportunity in 32-megabytes as well as 2-megabytes & 8-megabytes. How would you compare the opportunity in the higher density of 32-megabytes versus what we're seeing in 16? And do you -- think it will continue increasing from 32 to 64 to 128, et cetera, what would be kind of the incremental opportunity as we move up?

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

As we said, we're seeing increasing demand for higher densities. Our 16-megabit is one of our best-selling Toggle products today. So we're pretty enthusiastic about the opportunity for the 32-meg. And as I said, it's being received well by customers that are already taking samples and qualifying them in a number of our key market segment. In the engagements with customers about the new STT product line, likewise we're seeing a lot of enthusiasm for higher densities, where a lot of the non-volatile options don't compete. So it allows that to be done also using STT, which is much more cost-effective on a bit-per-bit basis versus Toggle. So we're pretty enthusiastic about both these opportunities.

Ariel Jonathan Shusterman ***Needham & Company, LLC, Research Division - Associate***

Right. Actually, just one more question. So when it comes to STT-MRAM. I know you guys wouldn't break up the mix between STT-MRAM and Toggle, but when would you say roughly, you expect STT-MRAM revenue to be greater than Toggle, if you had to give a rough time frame?

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

I think that's pretty hard for us to predict for you, Ari.

Operator

We have a follow-up question coming from the line of Richard Shannon with Craig-Hallum.

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

A couple more here. Kevin, you'd mentioned some details from the GLOBALFOUNDRIES tech event or whatever the name was. You mentioned they said a TAM of $500 million or so. Have they started to give you a forecast or some sort of production schedule about when we can start to see that pickup? I know you're confident it can happen next year or is that just an assumption on your part right now?

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

So first one, just to clarify, it wasn't a $500 million TAM, it was actually a $500 million design pipeline. So that's their quantification of the customers that they are tracking designs with on -- that are using embedded MRAM on their 22 FDX. And we continue to track what they've said publicly, which is that their -- that they expect their first production -- first customers to go into production next year. And that's probably the best guidance that I can give you there, Richard. I think based upon what we're seeing, we're confident that they have the capability, the partnership has been great. It's produced some great technology for us. We think that gives them a good advantage with their customers as well.

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

Okay, fair enough. My last question. I know that you're building out an expansion for your title business with SilTerra, maybe just give us a quick update there? And when do you expect that to be up and running? And when would you -- when do you think you would need that capacity as you start to fill up where you are today?

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

Yes. So that partnership goes along well. We've made tremendous progress towards our goal of getting into production. We've previously talked about that starting in 2020 and that will be towards the beginning of 2020. So yes, everything continues to go on track there. In terms of doing it on a needs basis, there are several advantages that gives us besides just the expanded capacity. We hope that that will be something that we can take advantage of as things continue to recover throughout the year, but there's also other benefits that come from having a diversified supply chain.

Operator

As there are no further questions at this time, I would now turn the call back over to Ms. Leanne Sievers.

Leanne K. Sievers ***Shelton Group - President***

Thank you, operator, and thank you, everyone, for participating on today's call. One final comment. We want to inform you that management will be attending the Craig-Hallum Alpha Select Conference in New York on November 12 and the Benchmark Discovery Conference also in New York on December 4. For those interested in scheduling a meeting, please contact the Shelton Group or the hosting firms. We look forward to reporting our progress and business results on our next quarter's call. Operator, you may now disconnect.

Operator

This concludes today's teleconference. You may now disconnect.