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IMI - Q4 2015 Intermolecular Inc Earnings Call

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## CORPORATE PARTICIPANTS

**Rick Neely** *Intermolecular, Inc. - SVP, CFO*

**Bruce McWilliams** *Intermolecular, Inc. - President, CEO*

## CONFERENCE CALL PARTICIPANTS

**Edwin Mok** *Needham & Company - Analyst*

**Gus Richard** *Northland Securities - Analyst*

## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Intermolecular's Fourth Quarter and Financial Year 2015 Earnings Conference Call. (Operator Instructions) Please note this call is being recorded. My name is Catherine, and I will be your operator for today. I would now like to turn the conference over to your host for today, Mr. Rick Neely, Senior Vice President and Chief Financial Officer. Please proceed.

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**Rick Neely** - *Intermolecular, Inc. - SVP, CFO*

Thank you, Catherine. Good afternoon, and welcome to Intermolecular's Fourth Quarter and Fiscal 2015 Earnings Conference Call. We announced our results after the market closed today, and you'll find a copy of the press release on our website at [www.intermolecular.com](http://www.intermolecular.com). On the call with me today is Bruce McWilliams, President and Chief Executive Officer.

Today's conference call contains forward-looking statements. Any statement that refers to expectations, projections or other characterizations of future events, including financial projections and future market conditions, is a forward-looking statement. Actual results may differ materially from those expressed in these forward-looking statements. Intermolecular assumes no obligation to update these forward-looking statements, which speak only as of today. For more information about factors that may cause actual results to differ materially from forward-looking statements, please refer to the press release we issued today, as well as the risks described in our Form 10-K for fiscal year 2014, as filed with the SEC, particularly in the section titled Risk Factors.

Before we begin, please note that during this call we will discuss non-GAAP financial measures as defined by the SEC in Regulation G. We believe non-GAAP financial measures provide useful supplemental information to both management and investors, but note that these measurements are not a substitute for GAAP and should only be used to evaluate the Company's results of operations in conjunction with corresponding GAAP measures. All non-GAAP measures are reconciled to the most directly comparable GAAP financial measurements in our press release issued today. I would now like to turn the call over to Bruce

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**Bruce McWilliams** - *Intermolecular, Inc. - President, CEO*

Thank you, Rick. Good afternoon, everyone, and thank you for joining us on today's call and webcast. When I came onboard a little over a year ago, my main objective was to reestablish a solid foundation of customers and redefine our business model. By unbundling our offering we can serve a broader market and become a leading source of materials, discovery and understanding. Specifically, my first goals were to rebuild the business with semiconductor market leaders and get the positive cash flow by the second half of 2016. I am pleased to report that we have accomplished these goals two quarters ahead of schedule. First and foremost, we achieved both positive EBITDA and positive operating cash flow in Q4. Adding semiconductor customers was key to achieving fourth quarter revenues of \$13.5 million, a quarter-over-quarter growth of 17%. We posted these results with three of the top five semiconductor manufacturers in the world, as greater than 10% customers have been in molecular. A year ago, only one was using our technology platform. We feel this is a strong indication that our new business model is working and that we have succeeded



in establishing a solid foundation of durable relationships. We believe we can continue to expand engagements in this industry in the years to come.

We also needed to demonstrate that we could build a scalable business with strong operating profit. The key to achieving this is a large market beyond semiconductor and a high gross margin because of the large fixed cost of the IMI platform. It's nice to report our gross margin in the fourth quarter was 68%, which is up significantly from the third quarter gross margin of 56%. Thus, we are able to reduce our non-GAAP loss to only \$0.02 per basic share in the fourth quarter from a loss of \$0.10 in the third quarter.

We are increasing revenue with very modest increase in cost. Our organization can now engage with more customers without significant capital investments or increases in personnel. I am happy to report that we are making progress on expanding beyond semiconductor. We have a new Fortune 500 customer who is using our platform for the discovery and understanding of metal alloys. This demonstrates that the same platform IMI built for semiconductor applications can be used for a completely new and different market. I believe our technology platform will be used for other applications and markets, such as in automotive, aerospace, energy and consumer electronics, thus enabling strong growth for the Company in the years ahead. I am looking forward to telling you more about these opportunities in the course of the year.

My goals for 2016 are to continue and strengthen what we started in 2015, namely, strong revenue growth, solidification and continued growth of our semiconductor business, expansion into new markets and applications, investing in new materials for future additional revenues, and continued improvements in operational efficiency.

In summary, IMI's business of providing technology-enabled services for the discovery and understanding of engineered materials is beginning to bear fruit. We now have a strong position in semiconductor. I believe we can build a business that scales well beyond the semiconductor industry long-term. We have a strong team, valuable capabilities, flexible tools in place to build a great business, and I'm confident results will continue to improve throughout 2016. Now, I would like to turn the call to Rick for more financial information and our next quarter's guidance.

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**Rick Neely** - *Intermolecular, Inc. - SVP, CFO*

Thank you, Bruce. Let me review some selected financial results for the fourth quarter and full fiscal year of 2015. As Bruce indicated, revenue for the fourth quarter was \$13.5 million, which was up 17% sequentially from the prior quarter, and up 22% compared to the fourth quarter of 2014. Program revenue represented approximately 78% of total revenue in Q4 2015, and licensing and royalty revenue came in at 22% for the quarter. We continue to see good growth in our program revenue, which is almost \$2 million quarter-over-quarter, as our new customers are running their programs for the entire quarter. For the full year, IMI revenue was \$45.8 million, down slightly from the fiscal 2014 result of \$47.7 million.

In Q4 2015, we had three customers which were each greater than 10% of total revenue. These three customers represent approximately 65% of the total revenue in the fourth quarter of 2015. Net loss in the fourth quarter of 2015 on a GAAP basis was \$1.9 million, or a loss of \$0.04 per basic share. This compares with a net loss of \$5.8 million, or a loss of \$0.12 per basic share in the previous quarter.

The fourth quarter net loss was a dramatic improvement from the third quarter of 2015, as new program revenues came in at higher gross margins and operating expenses actually declined quarter-over-quarter. In the same period a year ago we reported a quarterly net loss of \$6.1 million, or a loss of \$0.13 per basic share.

For the full fiscal year 2015, our net loss on a GAAP was \$20.4 million, or \$0.42 per share compared with a net loss of \$21.8 million, or \$0.47 per share in 2014. I would like to remind you to please review today's earnings press release for both GAAP and non-GAAP measures and the reconciliation between these results. The key difference from GAAP to non-GAAP measures is the exclusion of stock-based compensation expense and restructure-related charges. On this basis, we reported a non-GAAP net loss for the fourth quarter of 2015 in the amount of \$1.1 million, or a loss of \$0.02 per basic share. This compares to a non-GAAP net loss of \$4.7 million, or a loss of \$0.10 per basic share in the third quarter of 2015.

For the full fiscal year 2015, our net loss on a non-GAAP basis was \$14.8 million, or \$0.31 per share, compared to a net loss of \$14.4 million, or \$0.31 per share as well in 2014. As mentioned before, gross margin in the fourth quarter was 68%, which was up significantly. A higher gross margin reflects a greater portion of our program revenue under our new business model, which leverages our platform across similar projects and better



utilizes existing capacity. Our main focus continues to be on improving our total operating margin, not just gross margin, and we are pleased with the positive progress. I would like to point out, however, that going forward we would expect our typical gross margins to be in the 60% to 65% range.

As of December 31, 2015, our balance sheet included cash and investments of \$35.3 million, which was up \$0.8 million from the combined totals of \$34.5 million at the end of the third quarter of 2015. We achieved positive adjusted EBITDA in the fourth quarter of 2015, which was one of the key goals we set for IMI. This result was several quarters ahead of our projections and was largely due to better revenues and the operational leverage we are getting with our revised business model.

Looking at our quarterly GAAP loss of \$1.9 million on an adjusted EBITDA basis, there will be a profit of \$0.9 million when you remove \$2.1 million of depreciation and amortization, and \$0.8 million of stock-based compensation. This is a significant achievement and it highlights our low actual cash consumption and the capital efficiency of our new business approach. Now, I would like to go over the financial outlook for the first quarter of 2016. I would like to remind everyone that the following statements are based on current expectations as of today and include forward-looking statements. Actual results may differ materially.

Our guidance for the first quarter of 2016 is as follows. We project revenue in the range of \$13.7 million to \$14.2 million. Non-GAAP net loss, which excludes stock-based compensation expense, is projected between \$2.0 million and \$3.0 million, or between \$0.04 and \$0.06 loss per share on approximately 49 million shares outstanding. Now, I would like to return this call to the operator for any questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions) Our first question comes from Edwin Mok with Needham. Your line is open.

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### Edwin Mok - Needham & Company - Analyst

The first question I have is on the program that you mentioned with some of the newer customer, I think you mentioned that a new customer is now running a full order of programs and as a result helped drive the upside for the quarter. Should we assume those customers has already got fully ramped up and you need to have additional effort that could come later on the year for the growth of those customers, or are we looking for adding additional customers to drive growth?

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### Bruce McWilliams - Intermolecular, Inc. - President, CEO

I think both will happen. So, we're seeing the indication that some of the semiconductor customers want to grow further and the new customer in the metal alloys, you know, that really just came on at the very end of the fourth quarter, so that will contribute to growth. And more generally we're seeing that what we're offering the industry is unique in the ability of materials, discovery and understanding. So, we believe long term it will continue to add more customers and in certain cases those customers will continue to grow beyond where they're at.

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### Edwin Mok - Needham & Company - Analyst

I see, okay. I guess a question on, I guess, revenue and profit, gross profit. So, in the fourth quarter was there any kind of one-time benefit or one-time item that benefits revenue or gross margin for the quarter? And if I use your commentary correctly, you expect gross margin to be back in the 60%, 65% range in the first quarter; is that what you're saying, Rick?



**Rick Neely** - *Intermolecular, Inc. - SVP, CFO*

Edwin, yes. Relative to gross margin specifically, there was some year-end. You true-up your bonus, and there was also a drop-off in benefits costs because of everything gets axed out for a lot of people on Social Security. So, I don't know if you call it a one-time or more of a cyclical situation, but there were some bonus true-ups and things that lowered expenses and gross margin. It went the other way in some of the other operating expenses, but that's how gross margin was up a bit higher than we expected. That's why typically 60% to 65% would be what we're shooting for in our new business model. 68% is great, but that's probably not a go-forward number ever quarter.

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**Bruce McWilliams** - *Intermolecular, Inc. - President, CEO*

There were no significant one-time revenue things.

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**Rick Neely** - *Intermolecular, Inc. - SVP, CFO*

No, revenue was the new programs. Yes, recurring customers, I mean, we expect to recur.

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**Edwin Mok** - *Needham & Company - Analyst*

And then if I use the 60% to 65% range you mentioned and I assume you are modeling OpEx to increase in the first quarter, how do I think about OpEx beyond this quarter and longer term? Do you expect to continue to have increase that as you develop more materials or as some of the programs come online your operating expenses will moderate or stabilize?

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**Rick Neely** - *Intermolecular, Inc. - SVP, CFO*

Yes, as you can tell from the guidance, we are projecting some operating expense increases partly because some of it at the beginning of the year you're going to reset your benefits rates and things, so you're going to go up a little bit. We also have the impact of -- we are hiring modestly, and those people will be onboard a full quarter. So, we do expect some increase. But the way to think about what we've seen in our business model is we think we can achieve -- in fact, we achieved it in the last year and last five quarters is when we grow revenue, let's say we grow revenue at \$100, we don't want to increase expenses more than \$30. In other words a 70% incremental improvement. You've seen that over the last five quarters. We think we can keep that up, particularly in the near term, because we have a lot of excess capacity. So, you'll see modest increases in OpEx, but you'll also see more than that, much more than that on the revenue side.

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**Edwin Mok** - *Needham & Company - Analyst*

I see. Okay, great, that's helpful. And then, lastly, you mentioned that beyond semi, which you guys have done a good job on securing these new customers, ramping up the customer. You mentioned also about expanding the new market to include this new metal alloy that you mentioned, right? Any way we can think about how you think about semi versus nonsemi longer term, you know, say, three to five years out? Do you expect that non-semi piece to become bigger and bigger as you find new option of the model, obviously some of these newer markets that you have historically not touched, or do you think semi will still be the core business over the next three years?

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**Bruce McWilliams** - *Intermolecular, Inc. - President, CEO*

Yes, I think in the next three to four years semi will be maybe 50% of our business versus today it's 80%, 85%. So, now, I do believe we will continue grow in semi, and we will capture more significant players there and in those accounts some of them we will grow. But I think our growth opportunity in other industries is even greater. As we get out there and talk to everybody about our platform, all these industries need new materials and our platform is very good for discovery and understanding of new materials, and help them find solutions for their problems. And so I think that's why this is a very exciting company. The total market that we can grow into is very large, much bigger than semi. I think near-term semi is what moved



the needle and that's why we focused on it first, because we understood that market and we were tuned for that, but where we have increased spending is on marketing and sales, and we're now getting positioned to really get out there and go to these other industries with the same platform. And that's why we're convinced that this company can scale for many, many years.

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**Edwin Mok** - *Needham & Company - Analyst*

Okay, that's helpful. Last question and I'll let the other guys ask. So, with regard to the nonsemi or these newer industry markets that you guys put time in trying to understand what you can -- and it seems like you believe there is good optioning there. Do you think that those markets could potentially be more receptive to some kind of royalty arrangement? Because I think, Bruce, that you had suggested that in the semi space you focusing on standard programs, which help drive the program business and (inaudible) great margin, but (inaudible) scaling back on pursuing these royalty revenue of those programs. Is it the same strategy for the nonsemi or the industrial market, or are you seeing (inaudible) actually a better option to (inaudible) a royalty in this market?

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**Bruce McWilliams** - *Intermolecular, Inc. - President, CEO*

So, we see the licensing revenue is still an important component of our business long term. We're going to be adjusting our strategy. We're going to be talking about it more later in the year how we're going to make that work long term. Near term we don't expect a lot of -- this year a lot of growth and royalties, licenses. But to give you a clue to how our thinking is, in certain areas the material is close to the essence of a complete product. In the area of semiconductor, we're developing materials for a component of a large complex process, right? Our platform works very good for that, but there the royalty model is much harder to drive because we're just a small piece of a very big bill of materials. So, we're going to be focused on applications where the material is the essence of a product and in those industries we think we can make that line in our income statement grow long term. Long term is what leads to a business model with very high operating profit, because there gross margins are essentially higher. We're going to tell you more later in the year, once we have all the pieces together and can forecast things.

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**Edwin Mok** - *Needham & Company - Analyst*

Okay, great. Thanks. Looking forward to hearing from you, Bruce, and thanks Rick.

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**Operator**

Thank you. (Operator Instructions) Our next question comes from Gus Richard with Northland. Your line is open.

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**Gus Richard** - *Northland Securities - Analyst*

Yes, thanks for taking my question. A couple of quick ones. First of all, are you getting any interest from the logic portion of the market or is your revenue primarily still from the memory market?

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**Bruce McWilliams** - *Intermolecular, Inc. - President, CEO*

We are getting interest from that side of the market, and that we see is a growth opportunity in 2016.

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**Rick Neely** - *Intermolecular, Inc. - SVP, CFO*

Our current revenue growth, Gus, is all in memories.



**Gus Richard** - Northland Securities - Analyst

Yes, okay. And then you mentioned you had a Fortune 500 customer, you're working on alloys. Could you give us a little color on what the end application is? Is it for -- or characteristics of the alloy you're looking for, is it wear, lightweight? Any color there would be helpful.

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**Bruce McWilliams** - Intermolecular, Inc. - President, CEO

Well, part of the problem is we actually planned a press release on that customer in the next month or so, and it would be very sensitive for that customer to tell them specifically, because they have competitors, so we have to be careful. But I can say more generally in the area of lightweighting, high temperature, consumer electronics, they see a broad range of applications. But we can't tell you specifically what they're doing first. One of the things we're learning here, you know, these new range of customers, they, most all of them put in their contracts that we cannot disclose that we're doing work for them or what we're doing. So, I wish we could tell you, but there will be a press release later.

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**Rick Neely** - Intermolecular, Inc. - SVP, CFO

In this case we do have --

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**Bruce McWilliams** - Intermolecular, Inc. - President, CEO

Yes, in this case we got them to give us a press release because it's a new market.

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**Gus Richard** - Northland Securities - Analyst

Okay. And was this a new customer in the fourth quarter?

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**Bruce McWilliams** - Intermolecular, Inc. - President, CEO

They started paying us in the fourth quarter.

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**Rick Neely** - Intermolecular, Inc. - SVP, CFO

Part of the fourth quarter, but you'll see the full impact in Q1.

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**Gus Richard** - Northland Securities - Analyst

Okay, but is this -- let me try this one final way. Is this associated with the DOE contract you got awhile back, or is this something separate?

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**Bruce McWilliams** - Intermolecular, Inc. - President, CEO

It's not the DOE contract.

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**Gus Richard** - Northland Securities - Analyst

Okay. So, it's a separate contract in alloy.

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**Bruce McWilliams** - *Intermolecular, Inc. - President, CEO*

Yes. The good news is there will be a press release in a couple weeks and we can tell you everything, or you'll know everything then.

**Gus Richard** - *Northland Securities - Analyst*

Okay, perfect. I'll stop asking 50 questions on one thing. Appreciate it. Great quarter, guys. Thank you.

**Operator**

Thank you. And I am showing no further questions at this time. I would like to turn the call back to the Company for any closing remarks.

**Rick Neely** - *Intermolecular, Inc. - SVP, CFO*

Thank, everyone, for listening to our conference call this quarter and we're certainly looking forward to talking to you at the end of Q1. We'll see you then. Thanks.

**Operator**

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

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