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ATOM - Q4 2016 Atomera Inc Earnings Call

EVENT DATE/TIME: MARCH 07, 2017 / 9:30PM GMT



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CORPORATE PARTICIPANTS

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Scott Bibaud *Atomera Incorporated - President and CEO*

Frank Laurencio *Atomera Incorporated - CFO*

CONFERENCE CALL PARTICIPANTS

Cody Acree *Drexel Hamilton - Analyst*

PRESENTATION

Operator

Good day ladies and gentlemen and welcome to the Atomera Inc. Fourth Quarter 2016 Earnings Conference Call. (Operator Instructions) As a reminder, today's program is being recorded.

I would now like to introduce your host for today's program, Nick Kormeluk, Investor Relations for Atomera. Please go ahead.

Nick Kormeluk - *Atomera Incorporated - IR*

Thank you, Jonathan, and good afternoon. I'm Nick Kormeluk as Jonathan indicated and I'm leading the investor relations efforts here at Atomera. Joining me on today's call are Scott Bibaud, President and CEO; and Frank Laurencio, our CFO.

In addition to today's prepared comments, we have posted a slide deck to accompany our remarks on the investor relations portion of our Web site at atomera.com. You can find that by clicking on the event within the Investor section or under presentations. We will go ahead and forward those slides along as we go through the presentation, so you can follow along if you're able. After prepared comments by Scott and Frank, we will open the call up for your questions.

Please turn to slide 2 in the deck. Before we begin, I would like to remind everyone that during today's call, the company 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 the company's filings with the Securities and Exchange Commission, specifically in our final prospectus dated August 5, and filed with the SEC on August 8, 2016. Except as otherwise required by federal securities laws, Atomera disclaims any obligation to update or make provisions to such forward-looking statements contained herein or elsewhere to reflect changes and expectations with regard to those events, conditions, and circumstances.

Also please note that during this call, the company 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 and the presentation deck which is posted on the company's Web site.

Now I'd like to turn the call over to Atomera's President and CEO, Scott Bibaud. Go ahead, Scott.

Scott Bibaud - *Atomera Incorporated - President and CEO*

Thank you Nick. I'd like to welcome everyone to Atomera 2016 yearend results and business update call. I will begin with the progress report on our business covering our major accomplishments of Q4 2016 before turning the call over to Frank to briefly review our financial results. We will then open the call for questions.



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As a brief company overview Atomera is a pre-revenue materials and intellectual property licensing company focused on deploying on proprietary Mears Silicon Technology or MST into the semiconductor industry. Atomera's MST has been mentioned in the press as a possible solution to the recognized slowdown in Moore's law.

Using Atomera's technology, a silicon manufacturer can make power performance and cost improvements to their chips without requiring the capital investments necessary to score a move to the next process node, which can range from completely retooling an existing fab to building a new one from the ground up which can cause billions of dollars. If a customer elects to work with Atomera, we will execute a license agreement which grants them the right to manufacture using our technology in exchange for an upfront license fee and royalty payments of products built using MST.

You can go to Slide 3. Atomera's unique materials technology is relatively low cost to implement, but it does require a custom integration effort for every fab and process node. In our last call, we detailed the six phases we go through in a customer engagement as shown in Slide 3 from Phase 1 planning to Phase 6 production. And we committed to provide you with updates on our progress to those phases with our various customers. Phase 3 is the critical evaluation phase where customers decide whether to license the technology from Atomera, install MST deposition tools in their fabs, and move toward production where Atomera will start receiving royalty revenue.

Slide 4. As we mentioned in the past, Atomera seeks potential customers among the world of semiconductor foundries, integrated device manufacturers or IDM, and fabless semiconductor vendors. Any one of these potential customers can bring a significant revenue opportunity to Atomera, so any new customer engagement is an important event.

At the time of our IPO, we discussed in some detail our sales funnel and especially our top potential customers. Those top three lighthouse customers continue to perform evaluations in Phase 3. To date, none of them has made a license decision but the process of building wafers, testing them, and optimizing the integration in their fabs continues. Since the integration process requires a significant resource commitment by our customers, we believe that each month of continued evaluation is a vote of confidence in our technology and the benefit they can bring to their companies.

Slide 5. During our last call, I reported that we were seeing a growing interest from industry participant, and I discussed how the signing of NDAs with prospective customers is an important indication of their interest in us. In Q3, we reported two new NDA signings with one new customer officially entering the planning phase.

Slide 6. Building on that momentum, our marketing efforts are starting to bear fruit. Since our last call, we have signed five new NDAs, indicating that the industry is recognizing the potential of our technology. Four new customers have moved into Phase 1, which we defined as having a signed NDA and an active integration process discussion. One potential customer, a tier 1 IDM, has executed an evaluation agreement which Atomera defines as moving them into Phase 2, the setup phase which precedes their entry into the critical evaluation phase.

This new customer progress is very encouraging and provides us with the deepest and widest potential customer pool we have ever experienced as a company. At this point, we are engaged with 30% of the world's top semiconductor companies. Further, we have seen a significant reduction in the time frame from first contact to customer engagement.

Slide 7. Atomera has also made excellent progress this quarter in our internal development effort. It is our goal to both accelerate the phase of our internal technology development and to shorten the time required for customers to make a license decision.

Three things have come together this quarter to give us this improved development pipeline. First, yesterday we announced the collaboration with Synopsys to add Atomera's MST technology into their market leading TCAD software. When Atomera begins engagement with a customer, we spend significant time and effort planning how our technology will mesh with the unique process used in each of our customer's fabs. We must identify the most promising candidates from a large universe of potential processing option through simulation.

Synopsys helps us do that by adding MST into the TCAD model, the most highly regarded by our potential customers. Their software also allows us to demonstrate the benefits MST can bring to products within our customer's particular manufacturing flow. We believe this tool has the potential



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to cut the number of wafer runs and significantly reduce the time and cost required to integrate MST into a customer fab, leading to an earlier license decision.

Second, earlier this quarter we announced the partnership with TSI Semiconductors to run our own wafer experiments. But the real breakthrough in this announcement was a unique development vehicle which allows us to fast-track our experiments to process, test and learn from our wafer run. A typical customer wafer run takes from four to nine months to process before we get results, which means that in the past we got from one to three learning cycles per year. This new TSI arrangement gives us 15 to 20 cycles per year.

Just as an example, we received results from three separate wafer runs during the month of February alone. The faster results we received from TSI will allow us to optimize our MST film design and fix problems found during customer integration significantly faster than has been possible in the past, which should shorten our time to revenue with customers.

Finally, we've also secured access to dedicated epitaxial deposition or EPI tools for processing of wafers. This always available capacity will allow us to support the surge in new customer activity we are seeing at the beginning of our funnel and to keep driving internal development effort at our new faster pace.

With these three enhancements to our internal development process, they reinforced each other to provide a much bigger benefit than any of them would in isolation. Simulation means better test and faster results lead to better simulation; all enabled by tool availability. Inside Atomera, we're more optimistic than ever that we now have the capacity to support more customers with a broader set of solutions and to achieve faster integration, which should lead to faster commercialization with customers.

Slide 8. As we spend more time in discussions with senior executives in the semiconductor industry, we see four market segments which have challenges that Atomera's MST technology can help to solve. In the leading analog segment, manufacturers are struggling to find product improvements in an environment where process shrinks did not provide much benefit. In the mainstream segment, many fab managers are trying to determine how to extend a life of their facilities by bringing new technology in at existing nodes. Many chip designers, especially in memory are medium die sizes, are looking for ways to continue the future roadmap of leading planar process technology to avoid the high cost of FinFET. And in 3-dimensional technologies, they're looking for a solution which are lower risks and nearer term than many of the exotic materials currently under development. Atomera offers solution to the problems being experienced in each of these four segments.

Slide 9. And as you can see in slide 9, the good news is that Atomera currently has engagements underway in each of the four market segments. Many of our customers have a footprint in multiple of these segments, giving us a great ability to grow within a single customer. Since our IPO, we have dramatically improved our position in terms of both diversity of customers and the variety of market segments we are serving. I think you will agree that slide 9 shows a company which has lowered its risk and established a strong new customer, multi-segment growth potential.

I will now turn the call over to Frank for comments on the company's financial results for Q4 in the full year. Frank?

Frank Laurencio - Atomera Incorporated - CFO

Thank you, Scott. Please turn now to Slide 10. As you saw at the close of the market today, we issued a press release announcing our operating and financial results for the full year in the fourth quarter of 2016. We plan to file our annual report on Form 10-K with the SEC in the third week of March.

The most significant financial accomplishment of 2016 was the completion of our IPO on August 10th which brought us net cash proceeds of \$24.7 million. As of December 31, 2016, we had \$26.7 million of cash and cash equivalents. Due to the conversion at the IPO of our convertible notes in the common stock, we also have no debt.

We have slightly more than \$12 shares outstanding. Our GAAP net loss for the fourth quarter was \$3.4 million or \$0.28 per share compared to a net loss of \$4.1 million or \$3.08 per share in the fourth quarter of 2015. The main reasons for this quarter's lower net loss were as follows. First, in December of 2015, we recognized the \$2.1 million non-cash charge in connection with the exchange of legacy warrants and options as part of



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recapitalizations prepare us for our IPO. And second, we had \$567,000 in non-cash interest expense on our convertible notes in Q4 of 2015. Those notes were converted to equity at the IPO, so we no longer had any interest expense in Q4 of 2016.

For the full year of 2016, GAAP net loss was \$12.6 million or \$2.22 per share. And in 2015, the loss was \$9.5 million or \$7.55 per share. The main drivers of the increase in 2016 were \$4.5 million increase in operating expense as we ramped up efforts to commercialize our MST and \$710,000 increase in non-cash interest expense from the issuance of additional convertible notes in April of 2016.

Slide 10 includes a summary of our financial results for the fourth quarters and years ended December 31, 2016 and 2015. Our non-GAAP adjusted EBITDA loss for the fourth quarter was \$2.1 million compared to a net loss of \$1.4 million in the fourth quarter of 2015. For the full year in 2016, our non-GAAP adjusted EBITDA net loss was \$7.5 million and for 2015 it was \$5.1 million.

Slide 10 also contains a reconciliation between our GAAP and non-GAAP results. As you can see from the slide, the main differences between our GAAP and non-GAAP results consist of interest expense, loss on the recapitalization of warrants and options, and stock-based compensation. All of which are non-cash items. We believe that non-GAAP adjusted EBITDA, especially when use in connection with GAAP information provides a better view for investors. It is also what we used to plan our business.

Turning to the balance sheet, our cash and cash equivalents at December 31, 2016, were \$26.7 million, a decrease of \$1.5 million from \$28.2 million at the end of the third quarter. Our level of cash consumption during the quarter was significantly below our target run rate of approximately \$9 million per year despite the fact that we increased our total headcount by 25%. All of these increases came in the second half of 2016 and the first quarter of 2017. These new hires in research and development and sales are critical to supporting our increased engagements with prospective customers in our efforts to obtain license agreements for our MST technology.

The operator will now take questions.

QUESTIONS AND ANSWERS

Editor

Operator: (Operator Instructions) Our first question comes from the line of Cody Acree from Drexel. Your question, please.

Cody Acree - *Drexel Hamilton - Analyst*

Thanks, guys, for taking my questions and congratulations on the progress. Scott, maybe if you could maybe help us with those three top customers or leading customers, I guess, characterize them. What is -- what it's going to take you think to push them over the finish line to a final licensing agreement? I guess what steps are left and just as much color as you can provide?

Scott Bibaud - *Atomera Incorporated - President and CEO*

Sure, thanks, Cody. So those three customers are in our evaluation phase. And as it's shown in slide 3, I think, the evaluation phase is a phase that they can stay in for a period of time basically until they believe they have reached the targets that they want to reach before they make a license decision. And I've spoken about in the past the fact that typically it will take them four to six months to run a wafer evaluation, take -- do the testing of it and then at that point they make a decision about whether they're going to license with us or if they're going to do another evaluation run. It's very hard to call ahead of time. I think it's been -- one of the mistakes that we've made in the past is that we thought we could predict it with any certainty.



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But I can say that our relationship with each of those customers is very good. We work very closely with them and for each of them they are -- it seems like they're determined to continue testing and evaluation until they can get to a point where they can license this technology because they don't see many other alternatives in the market to get the type of improvements that we can give them.

Cody Acree - *Drexel Hamilton - Analyst*

Can you give us maybe some quantification what those improvements that you are at least, I guess, that through this evaluation phase to try identifying some range of efficiency, power, cost savings?

Scott Bibaud - *Atomera Incorporated - President and CEO*

Sure, I mean we have some -- we have some more details about this in our Web site. But for example on -- if a manufacturer were to be making a power management shift and they use our technology, some of our estimates were that they could get a 15% to 20% improvement in die size if our technology can be integrated successfully in their fab and they get the target performance improvements that we bring them. They'd also get a reduction in power consumption and -- so you can see this if they did get all those things they would be -- there would be a lot of money on the table to be able to afford to pay us the license fee.

Cody Acree - *Drexel Hamilton - Analyst*

Sure.

Scott Bibaud - *Atomera Incorporated - President and CEO*

In some of our other segments that I talked about later in the presentation, they're targeting to do other things than to save die size. But for each of the customers that we worked with, they see something in the technology we're bringing them that will bring very big benefits to their company.

Cody Acree - *Drexel Hamilton - Analyst*

And, Scott, with the R&D service agreements, I guess how much of this are you able to, I guess, would move up from the customer's burden to where you're able to do more the testing, more the qualification, how much of that still will have to be done in a prospective customer's fabs?

Scott Bibaud - *Atomera Incorporated - President and CEO*

Yes, the customer typically will -- still have to do the integration into their factory because every semiconductor process is different if you -- a process from Intel is not the same as the process from TSMC. And so -- but what our internal development process can do is if our customer is having a problem in their integration, we can quickly run some wafers in our own fab and in only a matter of weeks find a way that we may be able to solve that problem, make the suggestion to them so that when they do their next evaluation with us, it's much more likely to be successful. So, we believe our internal development efforts will shorten the amount of wafer cycles that a customer will have to go through in their evaluation phase.

Cody Acree - *Drexel Hamilton - Analyst*

Perfect. And then lastly, Frank, I guess just with your headcount increases and all the, I guess, the expansion of your engagements, do you believe you have the heads you need now and I guess just thoughts on OpEx spending for '17 or any increases in burn rate?



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Frank Laurencio - Atomera Incorporated - CFO

Yes, I would not expect an increase in burn rate beyond what we've guided. We gave the \$9 million number as a sort of expectation for 2017 and we stand by that. The headcount increases came later than we originally might have been targeting them, and that's why the \$1.5 million in burn last quarter was a little bit below what we had been expecting. So, the hiring was back-end loaded.

We maybe pausing a bit, but we do have in our plan to add additional headcount and -- but not to a point that would push us over that target burn rate. I think we are -- we're feeling definitely busy. Our folks are definitely working very hard with the engagements that we have. But as we absorb the new headcount, I think that we're right-sized for the customers that we've brought on board.

Cody Acree - Drexel Hamilton - Analyst

Perfect. Thanks, guys, and congrats on progress.

Operator

(Operator Instructions) And this does conclude the question-and-answer session of today's program. I'd like to hand the program back to Scott for any further remarks.

Scott Bibaud - Atomera Incorporated - President and CEO

Okay, thank you. So me let just thank everybody for attending today's presentation. We are very pleased with our customer pipeline progress this quarter and how well we're positioned for 2017. We have made very meaningful strides in executing our strategic plan and look forward to keeping you apprised of our progress.

Should you have any additional questions, please feel free to call Frank, Nick, or myself, and we'll be happy to follow up. We'll be marketing in New York City for the remainder of the week and apologize in advance if we're not able to immediately get back to you. We look forward to seeing some of you during our scheduled marketing activities later this week in New York, at the ROTH Capital Conference in Southern California on Tuesday, March 14th, or the Sidoti Conference in New York on Wednesday, March 29.

Thank you again for your support and look forward to our Q4 earnings call in early May. Thank you.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.

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