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ATOM - Q1 2018 Atomera Inc Earnings Call

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CORPORATE PARTICIPANTS

Mike Bishop *Atomera Inc. - IR*

Scott Bibaud *Atomera Inc. - President, CEO*

Frank Laurencio *Atomera Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Cody Acree *Drexel Hamilton - Analyst*

Brett Conrad *Longboard Capital - Analyst*

PRESENTATION

Operator

Welcome to the Atomera First Quarter 2018 earnings call.

(Operator instructions)

I would now like to turn the conference over to Mike Bishop. Please go ahead, sir.

Mike Bishop - Atomera Inc. - IR

Thank you and good afternoon everyone. I'm Mike Bishop with the company's investor relations. Joining me on today's call is Scott Bibaud, Atomera's President and CEO, and Frank Laurencio, Atomera's CFO.

In addition to today's prepared comments, we have posted a slide deck to accompany our remarks on the investor relations portion of our website at ir.atomera.com, and we invite you follow along with it as we go through our remarks. After prepared comments by Scott and Frank, we will open the call up for your questions. And now, please turn to slide two of the slide deck.

Before we begin, I would like to remind everyone that during today's call, we will make forward looking statements. These forward looking statements, whether in prepared remarks or during the Q&A session, are subject to inherent risks and uncertainties. These risks and uncertainties are detailed in the risk factor section of our filings with the Securities and Exchange Commission, specifically in our annual report on form 10-K for the year ended December 31, 2017, filed with the SEC on March 6, 2018.

Except as otherwise required by federal securities laws, Atomera disclaims any obligation to update or make revisions to such forward looking statements contained herein or elsewhere to reflect changes in expectations with regards to those events, conditions, and circumstances.

Also please note that during this call we will be discussing non-GAAP financial measures as defined by SEC regulation G. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures are included in today's press release, which is also posted to our website.

Now, I would like to turn the call over to our president and CEO, Scott Bibaud. Please turn to slide three. Go ahead, Scott.



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Scott Bibaud - *Atomer Inc. - President, CEO*

Thanks, Mike. And welcome to Atomer's 2018 first quarter business update call. Today I will start with a summary of accomplishments since our last update call in February. At that point, I'll turn the call over to Frank to review our financial results, and then I'll make some additional remarks before we open up the call to your questions.

If you are new to Atomer, we are a material and intellectual licensing company with a proprietary transistor enhancement film called Mears Silicon Technology, or MST. We are focused on solving one of the biggest problems facing the \$400 billion semiconductor industry today, the slowdown in Moore's Law.

Using Atomer's technology, a manufacturer can make meaningful power, performance, and cost improvements to their chips. They can use those improvements to avoid the capital investments necessary to build a multi-billion dollar next generation fab, to extend the life of an existing fab, or to make new fab investments even more attractive.

In many cases, customers who have exhausted all other opportunities for significant product enhancement look to MST as the only cost-effective solution for getting to the next level. If a customer decides to work with Atomer, we will execute a license agreement which grants them the right to manufacture with our technology in exchange for a license fee and royalty payments on shipments of their products.

Slide four. By now, most of you are familiar with our method of representing progress with customers through the phases of engagement shown here. Phase one includes only customers who are actively planning an evaluation of our technology. In phase two, we deposit our MST film on customer's wafers for the first time, and conduct physical characterization to ensure there's a match between their process steps and our technology.

Phase three is where customers incorporate MST during the production of their wafers and use the test results to verify our technology prior to a licensing decision.

These phases are only intended as an example of how we are likely to work with a typical customer. Frequently, our actual customer interaction does not follow this linear progression.

Slide five. For example, one of our customers completed installation of our MST technology in their factory in Q1 and are now at the point where they can deposit MST technology on wafers in their own facilities.

Not only is this a cost savings for the customer and Atomer, it will also decrease the time to do an integration run by over one month. Lower cost and faster results mean that customers will be quicker to try our technology on more integration lots and more process nodes, expanding our available market for licenses.

We will continue to encourage more of our customers to install MST early in our engagements, as we view this as a very positive way to develop customer champions who will have the expertise to optimize and propagate Atomer technology throughout that customer environment.

Slide six. Since our last call, we've made outstanding progress in moving our customers closer to a license decision. Three of our customers who have entered the critical third integration phase making nine customers who are now in active integration process with Atomer. Two of these customers moved directly from phase one, and one transitioned from phase two into phase three. Also, another customer in phase one has entered phase two.

This chart has always been used to report the number of customers with whom we are working, since we have had only one engagement with each customer. Of course each of their businesses includes a wide variety of process nodes and special technology variations, each of which represent a licensing opportunity.

With 14 potential customers in our pipeline, our focus has shifted from new customer acquisition to advancing existing customers forward to the point where they are ready to sign a license and go into production.



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Slide seven. In the past, we've asked customers to focus on a single process node early in our engagements. But requests have increased to perform trials in multiple areas within a single customer. I'm please to report that during Q1, three of our customers have added a second process node to their evaluations. Today, we actually have 17 different customer engagements underway.

Expansion of engagements within a single customer is a natural and efficient way to grow our available market. Each customer has shared resources like Epi process development and PCAT engineering, so to the extent we can educate those teams on MST, they become our advocates within the customer and will help us uncover new opportunities within that account.

Although happy to take on new customers, our priority is on making progress with existing accounts. And there's no doubt that we've executed very well towards that goal during Q1.

We continue to believe the cycle time on customer test vehicles is slower than normal due to the very high capacity utilization of industry factories. Even in this environment, customers continue to approve the allocation of precious fab resources to additional wafer starts on Atomera technology.

Slide eight. Atomera continues to gain credibility in the semiconductor industry and academic community. This quarter, we added five new papers providing details of our technology advantage to the Atomera website. Each was written in conjunction with an expert in the field, peer reviewed, and published in well-respected industry publications like the "IEEE" and "Applied Physics Letters."

The papers range from an analysis on how much MST can improve the yield of embedded SRAM to an explanation of how Doping Profiles can be controlled by an interstitial trapping.

Although the topics can be esoteric, these papers illustrate to our customers how Atomera's MST technology can help solve some of the difficult problems being experienced in today's high volume advanced technology production nodes, and solve new challenges that will arise in the cutting edge technologies being developed for tomorrow.

Let me give you a few examples. In the last few weeks, we've had two quite important patents granted to Atomera for something called punch-through stop layer using MST, a very compelling technology for use in more advanced devices to help prevent off-state leakage. Any company manufacturing 3D transistors like FinFET should be interested in this technology because off-state leakage is a big problem that the industry is trying to solve.

Our most recent paper, published in the "Journal of Applied Physics" with authors from UC Berkley and Excellus Technologies, shows promising experimental and simulation results for a new use model of MST.

Most of our applications are directed towards improving the channel of a transistor, which you can think of as a highway on which electrons flow. But here we show that MST can also be used to improve the shallow junction contacts made at either end of the channel. Think of these contacts as the on and off ramps to that electron highway.

Because these contacts account for more than half of the overall resistance, they pose a challenge getting increasing focus in advance technology process nodes. In other words, it's no good having a fast highway if it takes forever to get onto it. And MST provides a possible solution.

what the latest patents and publications prove is that MST works for the entire semiconductor industry, from the latest FinFET and advanced 3D nodes being pioneered right now to legacy analog and mainstream nodes currently in widespread use. That is why we are gaining traction in fabs and in additional nodes within those fabs, and why we have greater confidence than ever in our pipeline.

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



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Frank Laurencio - Atomera Inc. - CFO

Thank you, Scott. Please turn to slide nine. At the close of the market today, we issued a press release announcing our operating and financial results for the first quarter of 2018. Our GAAP net loss in the first quarter of 2018 was \$3.1 million, or 26 cents per share, compared to a net loss of \$3.5 million, or 31 cents per share in the first quarter of 2017.

The lowered net loss was due to a \$665,000 decrease in stock-based compensation expense as awards triggered by the closing of our IPO in August 2016 had vested in full by August of 2017. The decrease in stock compensation charges was offset in part by higher payroll expenses from increased headcount, as well as higher expenses related to outsource fabrication and testing.

Net loss per share was lower in Q1 2018 due to the lower net loss as well as an increase in weighted average shares outstanding. Non-GAAP adjusted EBITDA in the first quarter of 2018 was \$2.6 million, compared to a \$2.4 million net loss in Q1 of 2017. This increase is due to the higher headcount and outsources fabrication and testing that I just discussed.

Our press release in slide nine contain a reconciliation between our GAAP and non-GAAP results. As you can see, the major difference between our GAAP and non-GAAP results is stock compensation expense, which is a non cash expense item.

Looking at our results on a sequential quarterly basis, in first quarter 2018, GAAP net loss was \$3.1 million compared to a GAAP net loss of \$2.6 million Q4 of 2017. The increase in our GAAP net loss was due to a \$416,000 increase in operating expense, and the fact that we had revenue of \$110,000 in Q4 of 2017, but no revenue in Q1 2018.

Drilling down into the increase in operating expense, this was due to increased R&D spending on outsourced fabrication and testing, supporting more customer evaluations as well as higher G&A expenses for professional fees related to activities that tend to be more concentrated in the first quarter of the year.

These operating expense increases were partly offset by lower sales and marketing expense. Non-GAAP adjusted EBITDA loss of \$2.6 million in Q1 compares to a loss of \$2.1 million in Q4. The higher loss in Q1 reflected the fact that we had recognized engineering services revenue in Q4, as well as the increased operating expenses in Q1 that I talked about earlier.

Turning now to the balance sheet, our cash at March 31, 2018 was \$14.5 million, a decrease of \$2.8 million from \$17.4 million at December 31, 2017. Our cash consumption of \$2.8 million compares to \$2.9 million in Q1 of 2017, and \$2.2 million in Q4 of 2017.

As I explained in our first quarter call last year, cash usage in the first quarter of each year is typically higher than in other quarters due to the timing of annual payments that are then expensed ratably over the course of the year in our income statement.

We expect that our 2018 non-GAAP operating expense, which closely approximates our cash consumption, to be in the range of \$10 to \$11 million, consistent with the guidance I provided in our last call.

We recognized our first engineering services revenue in Q4 of last year. While we did not recognize revenue in Q1 of 2018, we are currently delivering services to customers that will result in us recognizing revenue in the second quarter at about the same range as our revenue in Q4.

Lastly, our outstanding share count, as of March 31, was approximately 12.4 million shares. If you can now turn to slide 10, Scott will give a few summary remarks before we open up the call to questions. Scott.

Scott Bibaud - Atomera Inc. - President, CEO

Thanks, Frank. In the last three months Atomera has executed on several important milestones on the road to a license. We completed the first installation on of MST on a customer's Epi tool, initiated our first multi-process evaluations at a number of customers, increased the number of

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customers in our integration phase by 50%, and we are delivering compelling new solutions to the most advanced problems facing our industry today.

Our engineers have been working hard to deliver compelling results to more customers across a wider set of process nodes and market segments.

The results of our most recent evaluation runs look promising and we'll be getting more data from customers over the next few months. Remember that a single customer going into high volume production at a single node can make Atomera profitable. Today, we are working on 17 customer engagements and our probability of reaching commercialization increases with each new one. What we believe the momentum of the last three months represents is an increasing critical mass towards an inevitable outcome, MST licenses with a number of important industry players.

We look forward to sharing more of our successes with you as we continue to build Atomera into an important and successful technology provider to the semiconductor industry. Operator will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Cody Acree, from Drexel Hamilton.

Cody Acree - Drexel Hamilton - Analyst

Thank you very much for taking the question and congrats on the progress. Scott, could you just elaborate a bit on the multi-process evaluations? That seems like a pretty large step that, if your customers are moving you into multi-processes, that they would be progressing closer to signing that license agreement; am I reading too much into that?

Scott Bibaud - Atomera Inc. - President, CEO

Yes, I think it's a great question, Cody. When we first started working with customers we tried to encourage them to focus on one process node so that together we could get a successful evaluation going before we moved on to another one.

Today, we have so much more experience working with customers, and we're using our TCAD modeling tool so successfully that when we go into a customer and we work with their TCAD teams, they instantly start thinking about multiple process nodes that they want to try things on.

It's not unusual for people to talk to us about two or three or even more potential things they'd like to try, and then we decide which ones we're going to focus on first. Yes, this is a really good development, if you think about it in the terms of cost of acquisition of a customer, the cost to acquire the second process node is quite low to us.

And also, it points to the fact that customers who've been working with us for some time are expanding to other process nodes, so that also means their confidence in our technology is high and expanding.

Yes I'm hopeful that this means we're getting closer to license deals with the customers that we're expanding into multiple process nodes on.



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Cody Acree - *Drexel Hamilton - Analyst*

And you mentioned the TCAD work, how much of this is driven by your partnership with Synopsis, and how much of that is accelerating into the multi-process evaluations?

Scott Bibaud - *Atomer Inc. - President, CEO*

Yes, definitely the partnership with Synopsis has enabled this. We've taken the software ourselves and we're kind of driving customers engagements with that, but I would say that the fact they introduced their software at the end of last September. We really started delivering it to customers in Q4 to start understanding their technology better and we've definitely seen a rapid improvement in how quickly customers can understand our technology and decide where to use it in their factories. It's been a big help.

Cody Acree - *Drexel Hamilton - Analyst*

And now that you have this multiple process engagements and much larger breadth of engagements with different OEMs, or different customers, can you characterize a percentage of the analog digital memory mix?

Scott Bibaud - *Atomer Inc. - President, CEO*

Yes, we typically try to avoid that breakdown, Cody, for confidentiality of our customers, especially in the case where we might have only one or so in a certain segment. But I would say that we are working today on customers in all four of the major segments that we talk about. And the largest percentage of our engagements are still in the leading analog space.

Cody Acree - *Drexel Hamilton - Analyst*

And then, lastly, Frank, you mentioned that you thought 2018 OpEx was going to be in that \$10 million to \$11 million range. It sounds like with your increasing engagements, do you have the leverage, without adding significant headcount, to keep the pace that it looks like you're accelerating to?

Frank Laurencio - *Atomer Inc. - CFO*

Yes, I do think so. We're not by any means saying that we won't look to add some additional headcount, although I think there's a lot of leverage in the model. As I think I've said in other calls and comes through in the remarks, a lot of the increases in operating expense tend to come from outsourced spending.

I think we get a lot of leverage from the tools that we lease today, and if there's any area where there could be increases further in operating expense; it might be on tool spending and metrology testing on the customer wafers. But those potential increases are baked into that guidance of \$10 million to \$11 million.

Cody Acree - *Drexel Hamilton - Analyst*

Great. Thank you, guys and congrats on progress.

Operator

(Operator Instructions)



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Randolph Kim from Longboard Capital.

Brett Conrad - Longboard Capital - Analyst

Hey, guys, it's actually Brett Conrad. We're listening on speaker phone here. I just have a question in terms of process efficiencies, is that more of an evolution, have you seen any breakthroughs recently in that or is it just kind of continual process improvement? Maybe you can just give us a little color on how things are going, and the tools involved, and what differences things are making, or what areas you're making better strides in than others in terms of type of process nodes. Just a little bit of color like that would be great.

Scott Bibaud - Atomera Inc. - President, CEO

Yes, okay. Brett, as you probably know, when we went public we really focused primarily on the leading analog space, and there's no doubt that that is an area where the industry needs a lot of help and have very few potential solutions to the problems they're facing. And so, yes, we've continued to have a lot of focus there.

But you can see that most of the papers I talked about on this call have been focused more at the most cutting edge technology. And so we are talking with and working with multiple customers in that area. The two segments, mainstream and the leading planar, both of those are areas where we are starting to gain significant traction with customers and we're delivering some very compelling results.

In the leading planar, in December we gave kind of a public seminar to an engineering conference about the improvements in variability that we can deliver with leader planar technology, which is really important in that space. Variability is one of their biggest problems.

And we had a thought leader in the industry, Professor Suman Datta from Notre Dame, who gave a presentation on that. We actually have a copy of this presentation on our website, but it's gotten a lot of interest in the industry, and has been something that we've been focusing on.

I'm not sure if I got to all of your question, but kind of making progress across all four of those segments.

Brett Conrad - Longboard Capital - Analyst

Okay, great. Thanks. No, no, that covers it enough, and we can delve deeper offline, so I appreciate that. Thanks.

Scott Bibaud - Atomera Inc. - President, CEO

Yes, sure. Thanks, Brett.

Operator

[Gerald Buckley], private investor.

Unidentified Participant

If I understood your observation correctly, you had introduced MST into the Epi tool of somebody, and that seems to me to be a pretty significant step along the way. I wonder if you'd comment on that, please?



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Scott Bibaud - Atomera Inc. - President, CEO

Yes, absolutely, we believe it's a big step. Just to give you an idea, if you're looking at the market, there are two main tool providers that probably own more than 90% of the world market, and the Epi tools, we work closely with both of them, ASM and Applied Materials.

The tools that they would use to do a deposition of our technology costs somewhere on the order of, let's say, \$3 to \$8 million depending, on whether it's for an advanced process or for large wafers versus smaller wafers.

But for a customer to decide that they're going to not only allocate that very expensive tool, or even buy a tool that expensive to work with our technology, and then, even more importantly, dedicate an engineer or more than one engineers to integrating our technology onto the tool and then working with it in their factory. That's a really big commitment on their part, and it does show a belief in kind of a long term desire to do development, and hopefully someday take this to volume production.

Because their alternative is to build wafers, and then put them in a package and send them to us, where we put our technology on them and send them back, and that's quite an expensive process for us, but for them, they don't have to buy a tool, they don't have to get a dedicated engineering team. By taking the step of actually installing it in their own factory, they're saying, "Okay, we see enough benefit here that we want to expend the extra effort and start to do it ourselves."

Unidentified Participant

One follow up question. How recent was that?

Scott Bibaud - Atomera Inc. - President, CEO

We started the process with them in Q4 and we completed the installation over the last couple months. It was about a three, four month process to get it installed, which is fairly typical for what we think we'll see.

One thing I'll also mention, Gerry, one of the things I think is the biggest advantage of doing this is that inside the customer now, we have an engineering team who understand our technology, and part of their definition of career success will be making our technology successful.

Hopefully, they'll see the advantages and start selling it to other groups within the company, which, obviously, is going to save us time and money, but more importantly we kind of have a big advocate in our customer camp, which is great.

Unidentified Participant. Okay, thank you.

Scott Bibaud - Atomera Inc. - President, CEO

Sure.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to Mr. Bibaud for any closing remarks.

Scott Bibaud - Atomera Inc. - President, CEO

Thank you for attending today's presentation. This first quarter's been a very productive one for Atomera, with great progress moving customers closer to a license decision. Please continue to look for our news, articles, and blog posts to keep you up to date on our progress. You can sign up

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for them, along with investor alerts, on our website, atomera.com. Should you have additional questions, please call Mike Bishop and we'll be happy to follow up.

We look forward to seeing some of you during our scheduled marketing activities, the next of which is the LD Micro Invitational Conference in Los Angeles on June 5. Thank you for your support, and look forward to our next update call in August.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect.

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