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ATOM - Q1 2017 Atomera Inc Earnings Call

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## CORPORATE PARTICIPANTS

**Nick Kormeluk** *Atomera Inc. - IR*

**Scott Bibaud** *Atomera Inc. - President and CEO*

**Frank Laurencio** *Atomera Inc. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Suji Desilva** *ROTH Capital - Analyst*

**Cody Acree** *Drexel Hamilton - Analyst*

**Gary Mobley** *Benchmark - Analyst*

## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Atomera Inc. Q1 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the call over to Nick Kormeluk. You may begin.

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### Nick Kormeluk - Atomera Inc. - IR

Thank you, Michelle, and good afternoon. I'm Nick Kormeluk and leading the Investor Relations efforts here at Atomera. Joining me on today's call are Scott Bibaud, our 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 website at atomera.com. After prepared comments by Scott and Frank, we will open up the call for your questions.

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 factor section of the company's filings with the Securities and Exchange Commission specifically in our annual report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 31, 2017.

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 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 the 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 posted on the company's website, as well.

Now, I would like to turn the call over to Atomera's President and CEO, Scott Bibaud. Scott?

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### Scott Bibaud - Atomera Inc. - President and CEO

Thanks, Nick. Welcome to Atomera's First Quarter 2017 Business Update Call. I will begin with the progress report highlighting major accomplishments, since our last update call on March 7. And then turn the call over to Frank, to review our Q1 financial results. At that time, then open up 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 our proprietary Mears Silicon Technology or MST into the semiconductor industry. Atomera's MST is a transistor enhancement technology, focused on solving one of the biggest problems facing the industry today. The slowdown in Moore's Law.

Using Atomera's technology, a semiconductor manufacturer can make power, performance and cost improvements to their chips without requiring the capital investments necessary to support a move to the next process node, which can range from completely retooling an existing fab to spending several billion dollars to build a new one from the ground up. 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 on shipments of their products.

As shown on Slide 4, starting in the third quarter of 2016, the semiconductor industry entered into a period of strong growth. Industry analysts are now predicting that chip sales will grow more than 10% in 2017. This is great news for Atomera since when times are good, industry companies tend to increase their R&D budgets to improve future chip performance.

Coincident with the growth in industry earnings, Atomera has seen a commensurate uptick in new potential customers interested in our technology and in using MST in a broader set of applications.

Slide 5. As detailed in previous calls, Atomera's customer engagement process goes through six phases from Phase 1 Planning to Phase 6 Production.

The most significant work done by Atomera and our customers is during Evaluation or Phase 3. In this phase, the customer runs a series of evaluation wafer lots through their factory or FAB, where we've worked together to integrate our advanced materials into their highly tuned manufacturing flow and evaluate the impact of MST -- of Atomera's MST technology on their product performance.

When a customer is convinced that our technology can be successfully integrated into their process flow and that it shows sufficient economic benefit, they will make a decision to license from us. This evaluation and integration process is both lengthy and unpredictable. Clearly, the more customers we have in Evaluation and the faster we can work through evaluation cycles with the customer, the closer we will be to license decisions and revenue. This is our management team's primary goal.

Slide 6. In our Q4 2016 Update Call, we reported a strong uptick in new customer interest across several different industry segments. At that point, we had a total of eight customers in the pipeline. Four were in the Planning phase, representing those with a signed NDA and an active interest in moving toward Evaluation with us. One customer had entered the Setup phase and our three original customers -- customers, were still in the Evaluation phase or Phase 3.

Only two months have passed since the last update call, yet we have seen excellent progress on the customer engagement front. Work with our three Evaluation phase customers continued during this quarter. One customer has graduated from Phase 2 to join the first three in the pivotal Evaluation phase. In addition, we have one new customer who entered the Planning phase for a total of five in Phase 1.

As mentioned on previous calls, it is possible for Atomera to be successful as a company with only one large customer. So, the expansion of potential customers in the Evaluation phase is very promising. Further, these are truly significant potential opportunities. Eight of these nine customers are among the top 20 largest semiconductor manufactures as measured by revenue.

Slide 8. This past quarter, Atomera began to harvest fruit from the new R&D infrastructure we spoke about on our last call. That infrastructure consists of our collaboration with Synopsys; our work with TSI Semiconductors as a development fab; our internally developed specialized test structures; and the secured EPI reactor facility. This new engineering pipeline has given us an ability to accelerate our development efforts ultimately leading to a shorter evaluation cycle and faster time to license decisions.

In prior years, we have been able to achieve less than one learning cycle per quarter. During the past three months, we successfully planned, processed and tested eight different wafer lots, which is a pace that even the world's most advanced fabs would agree is outstanding.



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Data from these wafer runs is helping us to gain visibility into areas that have, historically, been very difficult to penetrate. But designing our own experiments and having access to the wafers to perform post-processing metrology, we can isolate specific areas for optimization or characterization.

For example, one issue we experience when working with a customer, is the attribution of certain results to either the MST film itself or to how the film is being integrated into our customer's process flow. Our new R&D infrastructure allows us to decouple film performance from customer process flow. Now, we can optimize individual parameters in our technology by running an experiment, learning from the results, and then running another experiment until we've maximized performance.

We can also evaluate defective different manufacturing process integration techniques to simulate future customer evaluation runs. Ultimately, our recent fast-tracked R&D wafer runs are giving us the tools to show our customers higher performance results under many different kinds of integration conditions. We believe this will help cut the number of evaluation runs necessary before a customer reaches a licensing decision, which is important to the company because licenses lead to revenue.

In summary, these past two months have been enormously productive for Atomera. We have made progress with our existing customers, pushed new customers through the pipeline and shortened our development cycle time. As always, we are focused on achieving our first commercial engagement and believe we are making solid progress towards that goal.

I'll now turn the call over to Frank for comments on the company's financial results for Q1. Frank?

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**Frank Laurencio** - Atomera Inc. - CFO

Thank you, Scott. As you saw at the close of the market today, we issued a press release announcing our operating and financial results for the first quarter of 2017. We plan to file our quarterly report on Form 10-K with the SEC, later this week.

Please turn now to Slide 9. Our GAAP net loss for the first quarter was \$3.5 million, or \$0.29 per share compared to a net loss of \$3.4 million or \$0.28 per share in the fourth quarter of 2017; and a loss of \$2.5 million or \$1.54 per share in the first quarter of 2016.

Looking at the results in Q1 compared to Q4, operating expenses increased by \$134,000, primarily due to increased spending on testing to support our customer engagements, as well as increased headcount in R&D and sales.

As usual, we have included in our press release a comparison to our financial results from the prior year quarter, which was Q1 of 2016. However, we feel those year-over-year comparisons are not a useful indicator of our current progress as a funded public company. So, right now, we focus more on our sequential quarterly performance.

Our IPO closed in August of 2016 in the middle of our third quarter. At that time, all outstanding debt converted to equity and we issued restrictive stock and option awards that had been tied to the completion of our IPO. Starting in the fourth quarter of 2017, our year-over-year quarterly comparisons will no longer be affected by interest expense and comparisons of stock-based competition charges will be more meaningful.

Comparing our first quarter to the first quarter of 2016, net loss increased by \$1.1 million primarily due to a \$1.2 million increase in stock-based compensation, increased R&D and sales expenses from added headcount, and increased outsourced testing to support customer engagements. Those factors were partly offset by a decrease of \$562,000 in interest expense. Both the stock-based compensation and interest expense were non-cash items.

Atomera has no debt and we have slightly over 12.1 million shares outstanding.

Slide 9 includes a summary of our financial results for the quarters ended March 31, 2017 and 2016, as well as the quarter ended December 31, 2016. This slide contains a reconciliation between our GAAP and non-GAAP results. As you can see, the main differences between our GAAP and non-GAAP results consist of stock-based compensation and interest expense both of which are non-cash items for us.

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We believe that non-GAAP adjusted EBITDA, especially when used in connection with GAAP information, provides a better view for investors. It is also what we use for our internal business planning.

Turning to the balance sheet, our cash and cash equivalents at March 31, were \$23.8 million, a decrease of \$2.9 million from \$26.7 million at December 31, 2016. During the first quarter, we paid out slightly over \$800,000 for items that will be recognized ratably on our quarterly income statements over the course of 2017. These first quarter items consisted primarily of one, payout of our annual bonus for 2016; two, payout of accrued vacation in connection with a change in our policy on paid time off; three, payment of annual insurance premiums; and finally, other regulatory listing fee payments and software license renewals.

We expected our cash usage over the remainder of the year will be significantly lower than this past quarter and that for 2017, our cash burn will be around the \$9 million range, which is within the guidance we have previously provided.

During Q1, we added three new heads. Two of which are in engineering and one in sales.

Operator, we will now take your questions.

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### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Our first question comes from the line of Suji Desilva of ROTH Capital. Your line is open.

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#### Suji Desilva - ROTH Capital - Analyst

Congratulations on the progress you've made here. So, can you remind us the length of Phases 4, 5, and 6 once the customer begins install, to think about the time to revenue for some of the customers that are in Phase 3?

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#### Scott Bibaud - Atomera Inc. - President and CEO

Sure. Phase 4 is about three months long typically, plus or minus a month or two. Phase 5 is a typical qualification process that semiconductor fabs do for new process and that they're very good at. It usually runs about nine months to a year. And then, of course, in Phase 6, you're in Production and, hopefully, that goes for a decade.

So, from when, someone does a license with us, we're probably looking at a year and a half or so before we're starting to see royalty payments.

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#### Suji Desilva - ROTH Capital - Analyst

Okay, great. That's very helpful. Obviously, Phase 6, you want to -- you want to run from there. So, and then the customer count today of four that -- I think throwing into Phase 3, is there a notion to throw a wider net here with more customers? Or towards the exit of 2017, would it be more realistic to think you'll focus on the customer you have and try to get them over the finish line? What's the more realistic way that 2017 will play out?

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#### Scott Bibaud - Atomera Inc. - President and CEO

So, I -- right now, I'd say, our primary focus is more on getting people over the finish line than it is in continuing to fill the pipeline. At this point, we've got a pretty broad set of customers covering a number of applications. But I -- with early in my remarks, I mentioned how there's interest

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across the industry and it does seem like the industry is out looking for ways to spend some incremental R&D dollars. So, we certainly won't be turning away other customers that would be coming to us with interest. And in particular, there's some industry segments that we are going to try to go out and tap that we don't have customers in yet, so we'll continue pursuing them.

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**Suji Desilva** - *ROTH Capital - Analyst*

Okay. And then one question that may be a little bit harder to answer. But the customers you have that are close to becoming installed, are they different in size? Some larger companies, I know you said, among the top 20 semis companies or some smaller. And if so, would you just be able to handicap whether the smaller companies are more likely to close sooner or where the larger companies are? Any color there would be helpful. Thanks.

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**Scott Bibaud** - *Atomera Inc. - President and CEO*

So, at this point, we have four companies in the -- in Phase 3. And three out of four of those are very large companies. I would say, it's harder to handicap which among the first three would be the most likely to get over the finish line first. We always hope that the next set of wafers that comes through will be the one that causes them to make a license decision. But it's -- we found it historically hard to predict whether they'll go in for another round of evaluation before that happens.

So, it's a little bit of a probability game that we're playing here with each one of the three or four customers that we have, having some probability of doing a license decision in the near term.

I would say the one that just entered in has to go through a process in the evaluation cycle so they're unlikely to be the first one. But, it could be any one of the other three.

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**Operator**

Our next question comes from Cody Acree of Drexel Hamilton. Your line is open.

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**Cody Acree** - *Drexel Hamilton - Analyst*

Scott, maybe on your cycle time improvements, can you just maybe talk about how that's impacted your existing customers and maybe how that's -- what that's doing to attract new customers?

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**Scott Bibaud** - *Atomera Inc. - President and CEO*

Yes, I think the thing about -- our cycle time improvement is allowing us to get a lot of very specific data about different integration conditions that we might face. So if, for example, a customer has an unusual heat cycle sometime in their process of making wafers and they want to know specifically if we can handle that heat cycle with our film, we can now run a quick set of wafers and test for that and give them the results. And so, we're trying to anticipate the -- any kind of questions that future customers will bring to us and we will have the data ahead of time, hopefully, when they -- when they ask us the question.

Secondly, when -- what's typical is that when someone's going through an evaluation, they see something happen that they hadn't expected and we didn't expect either. As we are able to just gather a lot more data about our performance under different conditions, we'll be able to more effectively and quickly debug those type of issues in our customer's fab and then help them to set up another set of wafer runs that are much more likely to achieve success on the next go around. So, in the end, a very big difference. Yes.

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**Cody Acree** - *Drexel Hamilton - Analyst*

Thanks for that. Last quarter, you announced the addition to the Synopsys platform. I was just curious this quarter if that has helped to bring in any of these additional interested customers.

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

We've had some of the newer customers that we're talking to, they bring up the Synopsys thing. And they're interested in starting to see our TCAD -- our process integrated with their TCAD simulations, which are largely based on Synopsys. So I wouldn't say it's brought us any new customers yet, but it's definitely helping us to speed up the -- and make more accurate, the plans for evaluations that we have with the customers in the pipeline.

**Cody Acree** - *Drexel Hamilton - Analyst*

And then, last, Frank, you mentioned your expectation for cash burn. I guess just your thoughts on overhead [fall] -- headcount for the year.

**Frank Laurencio** - *Atomer Inc. - CFO*

Yes, I think that we are -- we feel like we're well staffed to support the work that we have right now. And as Scott mentioned, with the R&D efforts and the infrastructure that we have, we are definitely generating a lot more data through rapid testing. So, the headcount that we've added in engineering is really helping us to process that data. I would say that we will opportunistically look to add headcount, but more likely late in the year and not within -- and not in the very near term.

**Operator**

Our next question comes from Gary Mobley with Benchmark. Your line is open.

**Gary Mobley** - *Benchmark - Analyst*

I'm new to the Atomer story. So, forgive me if I ask my question incorrectly or naively. But how should potential customers think about the payback for MST both from a foundry perspective and as well for fabless companies? And are these customers in the pipeline evaluating MST for -- not only current process nodes, but making it a mainstay of future process nodes?

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

Yes. Good questions, Gary. So let me ask -- attack last first. But what we have seen in the past in the industry was innovations like strained silicon or some other material advance that goes into the process, is that it generally is introduced as a certain process node. And then future process nodes pull it forward. I know there's some specialty foundries who've actually made a bit of a cottage industry out of taking advances that come in later nodes and then pulling them backwards into earlier nodes to get better performance. So I think we'll see a little bit of both of those happening with going back and forth.

We do have customers in -- I think you were asking in a bunch of different process nodes?

**Gary Mobley** - *Benchmark - Analyst*

Well, I was asking about how customers, potential customers, should view the payback.



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**Scott Bibaud** - Atomera Inc. - President and CEO

Oh, okay.

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**Gary Mobley** - Benchmark - Analyst

In [the dollars] in MST.

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**Scott Bibaud** - Atomera Inc. - President and CEO

Yes. So, I mentioned earlier about the economic benefits, that's a conversation that we always have with the customers, right. So, when we go into a customer, we -- depending on the application that they're going after, we sometimes can give them benchmarks based on our own simulations about how much of an improvement they'll be able to get, but it's always an estimate because the improvement in performance is going to be -- is going to be affected by their integration -- I mean their process of manufacturing the wafers and how well we integrate with it.

So, but some of them will give us a number and say, we're looking for a 12% improvement or 15% improvement. And underneath that number is a statement of them understanding how much it will cost -- incremental costs to run wafers using our EPI process; payment to us of a royalty; and then, obviously, a piece of extra profit for them and the customer's also experiencing some savings. All those pieces have to come together for people to find enough economic benefit to work with our technology.

So, that's the typical calculation. I think the good news is for many of the companies we're talking with, they can't see many opportunities to bring in innovation that's internally developed that has the type of improvement potential that ours does. And so, they're very motivated to work with us and keep going through evaluation until they can hit the numbers they want to hit to be able to make it economically viable.

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**Gary Mobley** - Benchmark - Analyst

Okay. That's helpful. And just to follow up to that. Is this a game shared type royalty model?

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**Scott Bibaud** - Atomera Inc. - President and CEO

No. It's more along the lines of an [ARM] royalty model. We're just charging a percentage of ASP either for wafers or for chips.

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**Operator**

(Operator Instructions) There are no further questions. I'd like to turn the call back over to Scott for any closing remarks.

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**Scott Bibaud** - Atomera Inc. - President and CEO

Okay. I want to thank you all for attending today's presentation. We are very pleased with our customer and development progress this quarter and we will continue to be focused on achieving first commercialization with the customer and look forward to keeping you apprised of our progress. Should you have additional questions, please call Frank, Nick or myself. We'll be happy to follow up. We look forward to seeing some of you during our scheduled marketing activities, the first of which is the B. Riley conference in Los Angeles on May 24 and 25 and the Marcum Investor conference in New York City on June 15 through 16.

Thanks again for your support and we look forward to our Q2 Earnings Call in early August. Thank you.





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## Operator

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

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