Q3, 2018 Earnings Conference Call Prepared Remarks

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Thank you, Towanda. Welcome, everyone, and thank you for joining us today for QuickLogic's Third Quarter Fiscal 2018 Results Conference Call. With us today are Brian Faith, President and Chief Executive Officer, and Dr. Sue Cheung, Chief Financial Officer.

Before we begin, I will read a short safe harbor statement. Some of the comments QuickLogic makes today are forward-looking statements that involve risks and uncertainties, including but not limited to stated expectations relating to revenue from new and mature products, statements pertaining to QuickLogic's future stock performance, design activity and its ability to convert new design opportunities into production shipments; timing and market acceptance of its customers' products; schedule changes and projected production start dates that could impact the timing of shipments; the company's future evaluation systems; broadening the company's ecosystem partners, expected results, and financial expectations for revenue, gross margin, operating expenses, profitability and cash. These statements should be considered in conjunction with the cautionary warnings that appear in QuickLogic's SEC filings. For additional information, please refer to the company's SEC filings posted on its website and the SEC's website.
Investors are cautioned that all forward-looking statements in this call involve risks and uncertainties and that future events may differ materially from the statements made. For more details of the risks, uncertainties and assumptions, please refer to those discussed under the heading "Risk Factors" in the annual report on Form 10-K for the fiscal year ended December 31, 2017, the company filed with the SEC on March 9, 2018. These forward-looking statements are made as of today, the day of the conference call, and management undertakes no obligation to revise or publicly release any revisions of the forward-looking statements in light of any new information or future events.

Please note, QuickLogic uses its website, the company blog QuickLogic HotSpot, its corporate Twitter account, Facebook page, and LinkedIn page as channels of distribution of information about its products, its planned financial and other announcements, its attendance at upcoming investor and industry conferences, and other matters.

Such information may be deemed material information, and QuickLogic may use these channels to comply with its disclosure obligations under Regulation FD.

The conference call is open to all and is being webcast live.

We will start today's call with the company's strategic update from QuickLogic's CEO Brian Faith. Then CFO Sue Cheung will provide financial results and guidance. Brian will deliver closing remarks and open the call to questions.

At this time, it is my pleasure to turn the call over to Brian Faith, President and CEO. Please go ahead, Brian.

Brian Faith – Chief Executive Officer

Thank you Moriah, and thank you all for joining our Q3, 2018 conference call.

I have quite a bit of exciting news to share with you today that bolsters our outlook for 2019 and beyond.

Since our last conference call,

- We have expanded the scope and value of our MOU with a leading Japanese smartphone company
- We have broadened our involvement with the leading Consumer Electronics company we mentioned on our last conference call that has designed in our EOS™ S3 in an AC powered always-on / always-listening application
- We have initiated a new EOS S3 engagement with a leading Consumer Goods company for a high-volume AC powered always-on / always-listening application in yet another new market sector for QuickLogic
- And, I am very proud to announce we are forecasting material QuickAI™ revenue for Q4 2018

An important point for QuickLogic that I want to highlight is the fact we are seeing mounting evidence of a broad industry shift from push to talk to always-on / always-listening voice interfaces. Our recent design wins and engagement activities suggest this trend is in the process of extending into a very wide range of end markets, many of which are totally new markets for QuickLogic.

This shift to always-on / always-listening is important for QuickLogic because there is a focus on minimizing the power consumption of the interface and that is where our multi-core EOS S3 SoC has a clear competitive advantage.

We are even seeing the focus to minimize power consumption in AC powered products that are obviously not worried about battery life but need to comply with new energy standards that limit standby or vampire power consumption.

This was the driver for the leading Consumer Electronics company that selected our EOS S3 for new products that will be shown in a couple months at CES and it is also the driver for our engagement with the leading consumer goods company.

The shift to always-on / always-listening is also punctuated by the release of Amazon's new Close-talk Certification specification for always listening products. Prior to the release of this specification, all the Alexa-compliant hearable and wearable devices in the market were push to talk.

There are a variety of good reasons why Amazon took extra time and care in drafting its new Close-talk specification, but they can be boiled down to insuring the quality of the Alexa experience across a vast number of third-party devices is consistent with the consumer expectations that Amazon has carefully fostered with its Smart Speakers.

After implementing a software revision to accommodate a new requirement, we tested our EOS S3 against the Close-Talk Certification Test with one mic and two mic configurations. Both configurations passed the test.

With the specification released and the assurance of our internal test results, our hearable customers are implementing our latest software and modifying their designs as necessary to insure compliance. One of our larger customers is close to completing this cycle and will submit its hearable device to Amazon this month for Certification.

Our other customers are in various stages of internal testing and design modification. Based on what we know today, we expect the first of these products to move into production late this quarter and the balance during Q1 2019. While these delays impact our Q4 revenue outlook by more than a half million dollars, we now have a much clearer roadmap to revenue than we did three months ago.

We have made solid progress on all fronts of our ArcticPro™ embedded FPGA IP initiative. On the foundry side of the equation we completed our qualification for GLOBALFOUNDRIES' 22nm FD-SOI fabrication process that is marketed as 22FDX®.

This means we have three process nodes qualified at GLOBALFOUNDRIES and that QuickLogic is the only source for embedded FPGA IP that is qualified on an FD-SOI process.

This is important because the GLOBALFOUNDRIES' 22FDX process is optimized for low power and low cost and is being targeted by numerous semiconductor and systems companies for new SoC and ASIC designs. These include several of our ongoing ArcticPro eFPGA engagements and the RISC-V Parallel Ultra Low Power or PULP IC from ETH-Zurich, which some of our customer engagements intend to use as a platform to evaluate our ArcticPro embedded FPGA IP.

In addition to GLOBALFOUNDRIES, we also have a fabrication process qualified at SMIC and TSMC and have completed the porting to support a second and more advanced fabrication node at TSMC.

On the customer side of the equation, the new go to market strategy we introduced earlier this year continues break the Catch-22 loops that were stalling our engagements.

The short story is semiconductor companies wanted to run test chip experiments with our embedded FPGA technology before committing a significant amount of money to acquire an IP license for a new SoC design. To accommodate this and move the engagements forward, we created a Master Technology License Agreement or MTLA. This solved two problems.

First, it enables semiconductor companies and OEMs to build test chips using our ArcticPro embedded FPGA IP for only a modest cash investment. This provides them an opportunity to evaluate and quantify the benefits of our embedded FPGA IP ahead of making a commitment to a new SoC design.

Second, the MTLA defines the terms and conditions of follow-on IP licenses. This means the vast majority of the negotiations and legal work is accomplished within the MTLA and the follow-on license agreements for targeted SoCs amount to only a couple pages that can be executed quickly without disrupting design flow. This is often critical since an SoC design group that wants to use eFPGA may otherwise decide it does not have the time to go through tedious corporate level approvals and license negotiations.

This strategy also enhances our position with large semiconductor companies. With an MTLA and test chip in place, SoC design groups throughout large semiconductor companies are exposed to the availability of our solution and can realistically consider it just as they would other IP blocks that are typically included in SoC designs.

We signed our first two MTLA's with ETH Zurich and C-SKY, which was subsequently acquired by Alibaba. In line with the outlook we shared last quarter, we are on pace to sign additional MTLAs with semiconductor companies this quarter.

C-SKY and the IC R&D team at Alibaba's Discovery, Adventure, Momentum and Outlook Academy or DAMO are the cornerstones of Alibaba's new semiconductor initiative called Pingtogue Semiconductor. We believe our MTLA with C-SKY will drive multiple SoC licenses beginning in 2019.

ETH Zurich selected our ArcticPro embedded FPGA for use in its RISC-V PULP platform that will be fabricated using GLOBALFOUNDRIES' 22FDX fabrication process. ETH is currently targeting the tape-out for its PULP platform later this quarter and stated it will develop a number of compelling use cases that highlight the benefits of our embedded FPGA IP.

The PULP platform will give our potential IP customers the ability to evaluate the power savings and performance improvements that ArcticPro embedded FPGA hardware implementations deliver relative to software solutions running on the integrated RISC-V processors.

This is critical for many use cases where designs must maintain the flexibility needed to adapt to new algorithms yet still be optimized for performance and ultra-low power consumption. This is a very common use case for discrete FPGAs today.

As we move now to EOS S3, I'm proud to announce we shipped record EOS S3 revenue in Q3 and continue to win some very impressive high-volume designs. However, we also continue to deal with one frustration.

There was a shift in priorities at the tier one smartphone customer that we've been working with for quite some time on three product designs.

As I reported in our last conference call, our EOS S3 was one of two ICs competing for the high-volume consumer wearable device the customer was targeting to have production ready by the end of 2018. However, due to new wearable products that were recently released by our customers competition, the consumer wearable design was pulled back for review and the customer is dedicated 100% of its resources to reevaluating the design.

As it stands today, our EOS S3 remains one of two solutions in the running for this design. Working in our favor is the fact EOS S3 has lower power consumption, a smaller package size and is lower cost than our competition. While battery life, PCB space, and cost are clearly important, the customer is considering adding features that would require it to use the competitive solution that has more on-chip memory.

Due to the customer's all-hands-on-deck focus on the consumer wearable, final qualification and testing for our design win in the other wearable device and the EOS S3 evaluation for a new hearable device have not moved forward since our last conference call.

Last May, Naver Labs released its first consumer product, the AKI smartwatch, which uses our EOS S3 to enable its always-on / always-listening voice interface. Naver Labs recently received notice from a supplier that a key component used in AKI will be discontinued.

As a result, Naver Labs is faced with the choice of redesigning AKI, making a "lifetime buy" of the component or a combination of both options. We have not received notification from Naver Labs yet as to what it will do. Due to this, we are modeling only modest shipments to Naver this quarter for AKI.

While this is clearly an unexpected setback, we developed a close working relationship with Naver Labs during the AKI development cycle that extends to its senior executives.

Through this, and the design experience and IP that Naver Labs developed while working on AKI, our EOS S3 SoC has been selected for a new wearable design that is targeted for release in 2019.

EEBBK had a very successful launch of its two new educational tablets that use our EOS S3 to enable easy and intuitive voice communications. As is the case for U.S. suppliers, Q3 is a seasonally strong quarter for educational products in China. Due to this, we are anticipating a seasonal decline in Q4 followed by seasonally stronger demand in Q1.

We have an ongoing engagement with EEBBK for a new high-volume product that is scheduled for release in 2019.

Last quarter I announced that we signed an MOU with a large Japanese smartphone company. Since then we have expanded the scope and value of the agreement significantly. With this expansion, the OEM has agreed to standardize on our EOS S3 SoC for all of its MCU applications in smartphones, feature phones and IoT products.

The selection of EOS S3 as a standard to be used across a broad scope of products by a major OEM is a big and unprecedented deal for QuickLogic.

Last quarter I mentioned a very significant design win with a leading Consumer Electronics company. While we continue to operate under a strict NDA with this company, I can provide the additional color I committed to have this quarter.

- The design is in a new consumer electronics product class for QuickLogic.
- The core design is a platform that will be used by multiple OEMs.

- In total, there could be ten or more models from various OEMs that use this platform design or an integrated version of the platform.
- The lead OEM is integrating the design into four initial models that we believe will be shown at CES.
- Higher volume models are expected to have values that range from low to mid-seven figures.
- We expect to initiate production shipments for the first models introduced at CES in late Q1 2019 with volume ramping in subsequent quarters.
- We are in the early stages of a new design opportunity with this OEM that originated from the platform design.

In addition to our recent success in consumer electronics, we are in the early stages of an EOS S3 engagement with a leading Consumer Goods OEM. This application represents yet another totally new product category for QuickLogic and has low to mid-seven figure annual potential. If we are successful in winning the design, we expect it will move into production during the first half of 2019.

We are also working closely with this company as it evaluates EOS S3 for a new platform design that targets a variety of high-volume consumer products; all of which would represent new product categories for QuickLogic.

Before I turn the call over to Sue, I have some very exciting QuickAI news to share. I'm proud to announce that we anticipate reporting material QuickAI revenue in the fourth quarter.

In looking towards the future, we believe this first QuickAI design win will drive low seven-figure revenue in 2019. In addition to this, we already have several other QuickAI engagements that have the aggregate potential to drive low to mid seven-figure revenue in 2019 and have product lifecycles that extend for years beyond that. We have opened a new engineering office in San Diego to support these engagements and other QuickAI development activities.

I realize that given the very rapid move from introduction to material revenue leaves you with many questions, and I'm as anxious to provide those answers as you are to hear them. However, we are not quite ready to tip our hand to the competition. Our plan is to provide more color about QuickAI later this quarter, and with that, illustrate how our EOS S3 SoC plays a very important role in the high-value integrated solution.

I would now like to turn the call over to Sue for discussion of the financials, Sue:

Dr. Sue Cheung– Chief Financial Officer

Thank you, Brian. Good Afternoon and thanks to everyone for joining us today. Please note we are reporting our non-GAAP results. You may refer to the press release we issued today for a detailed reconciliation of our GAAP to non-GAAP results and other financial statements. We have also posted an updated financial table on our IR web page that provides current and historical non-GAAP data.

For the third quarter of 2018, total revenue was $3.5 million and within our guidance range. Our new product revenue was $1.5 million, and mature product revenue was $2 million. New product revenue was below our expectations due to delays associated with the release of the Amazon specification, and mature product revenue was above our expectations due to higher than usual seasonal demand.

Due to our continued success in diversifying our customer base, we had four customers with greater than 10% of total revenue in the third quarter.

Our Q3 2018 gross margin was 50.5%, and within our forecasted range.

Operating expenses for Q3 rounded up to $4.5 million and were within our forecasted range. R&D expenses were $2.2 million and SG&A expenses were $2.2 million. R&D expenses were lower than anticipated due to the timing of certain engineering projects.

The net total for other income, expense and taxes in Q3 2018 was a $33 thousand charge, which was below our forecast due to foreign currency exchange fluctuations. Net loss was $2.7 million, or $0.03 per share, which was within our forecasted range.

Net cash usage during the third quarter was $1.6 million, significantly below our expectations. The lower than expected cash usage was driven mostly by a large decrease in accounts receivable that was attributable to the timing of shipments in Q2 and Q3 that more than offset a decline in our accounts payable. Cash usage also benefitted from a $120 thousand decrease in inventory net of reserves taken during the quarter.

In September, we entered into a new loan agreement with Heritage Bank of Commerce for a $9 million revolving line of credit. This credit facility increased our access to working capital, extends the term for two years, and replaces the prior $6 million credit facility with Silicon Valley Bank. As you notice on our balance sheet, we have borrowed $9 million from this new facility, which illustrates to our customers that we have the capital in hand to support their orders. We are confident that Heritage Bank is the right partner to support our future working capital needs as our revenue grows.

Turning to the fourth quarter 2018 outlook:
Our revenue guidance for Q4 is approximately $3.5 million, plus or minus 10%. Total revenue is expected to be comprised of approximately $2 million of new product revenue and $1.5 million of mature product revenue. The sequential increase in new product revenue is expected to be driven mostly by higher EOS S3 revenue, which includes a material revenue contribution from QuickAI that more than offsets the anticipated decrease in display bridge revenue.

On a non-GAAP basis, we expect our gross margin to be approximately 50% plus or minus 3 percent.

We are forecasting non-GAAP operating expenses at approximately $4.9 million, plus or minus $300 thousand. We expect our non-GAAP R&D expenses to be approximately $2.6 million, and non-GAAP SG&A expenses to be approximately $2.3 million. The sequential increase in R&D expenses is attributable to higher forecasted costs associated with our embedded FPGA and QuickAI initiatives.

We expect our other income, expense and taxes will be a charge of approximately $60 thousand.

At the midpoint of our forecast, our non-GAAP loss is expected to be approximately $3 million, or $0.03 per share.

As was the case in prior quarters, the main difference between our GAAP to non-GAAP results is our stock-based compensation expense, which we expect to be approximately $480 thousand for the 4thquarter.

In Q4, we expect to use between $3.5 and $4 million in cash. The anticipated sequential increase in cash usage is mostly attributable to increased R&D spending and timing of working capital requirements.

With that, let me now turn the call back over to Brian for his closing remarks.

Thank you, Sue. Before opening the call for Q&A, I want to take a moment to highlight what I think are some important points for our investors to take away from this conference call:

The MTLA strategy that we introduced earlier this year to accelerate the adoption of our ArcticPro embedded FPGA IP is breaking the Catch-22 loops that were stalling our license engagements. We signed two MTLAs earlier this year and expect to sign several more this quarter. We believe we will start to see IP license agreements targeting specific SoCs beginning in Q1 2019.

We are seeing mounting evidence that major OEMs are moving away from push to talk technology and adopting always-on / always-listening voice interfaces. This trend has led to increased interest in our EOS S3 SoC from OEMs in a wide variety of end markets.

Amazon has released its new Close-talk Certification for always-on / always-listening products. We have numerous EOS S3 customers that have been waiting for this release and are now adapting to the new requirements that will enable them to brand their products as "Alexa Enabled." We expect the first of these products to move into production late this quarter and the balance during Q1 2019.

We have significantly expanded the scope and value of our MOU with a major Japanese smartphone OEM. With this, the OEM has agreed to standardize on our EOS S3 SoC in all of its MCU designs in smartphones, feature phones and IoT products. We expect the first smartphone to be released during the spring of 2019.

Beyond mobile applications where our EOS S3 is often selected to optimize battery life, we are winning designs in AC powered products that target compliance with new standby power requirements.

In these applications, the ultra-low-power and the ease of using our EOS S3 are obvious benefits. More subtle though is the multi-core architecture that includes embedded FPGA. In these applications the embedded FPGA provides the flexibility needed for platform designs that must interface with multiple end products and the ability to reduce the chip count of designs by absorbing functions in the embedded FPGA that would otherwise require external ICs.

We have won a major EOS S3 platform design with a leading Consumer Electronics company that represents a totally new market category for QuickLogic. We expect the first four products using an integrated version of the platform to be shown at CES in January. Following that, we expect multiple OEMs to introduce a total of ten or more new products using the platform design. The higher volume products have low to mid seven-figure potential for QuickLogic.

We are engaged with a leading Consumer Goods company for a high-volume AC powered design in another new market category for QuickLogic. If we are successful, we expect this design to go into production during the first half of 2019.

To say QuickAI is being well received would be an understatement. We expect to report material QuickAI revenue in Q4, which is several quarters ahead of our original forecast. QuickAI is a high-value integrated solution that brings EOS S3 into a vast number of new markets with product lifecycles that typically run for many years.

I am looking forward to providing more color about QuickAI later this quarter, and with that, I think you will appreciate its potential to deliver significant revenue in 2019 and beyond.

At the bottom line, we believe our growth strategy for 2019 is sound and bolstered by our recent successes. We also believe we are set to enter next year with far less dependence on single designs, single customers and on products that require third party qualifications.

Operator, I would like to now turn the call over for questions.

We will be participating at the following investor and industry events:

- The 4th Annual ROTH Technology Corporate Access Day being held at the Empire Steak House in New York on November 14th.
- The 9th Annual Craig-Hallum Capital Group Alpha Select Conference being held at the Sheraton New York Times Square Hotel in New York on November 15th.
- The ICCAD China 2018 conference in Zhuhai, China on November 29-30th.
- The Benchmark Company Discovery One-on-One Conference being held at the Palmer House Hilton in Chicago on November 29th.

- The RISC-V Summit in Santa Clara, CA on December 3-6th.
- The LD Micro Micro-Cap Main Event being held at the Luxe Sunset Hotel in Los Angeles on December 4th.
- A wide range of OEM products showcasing various QuickLogic devices will be at our demo suite at CES 2019 in Las Vegas from January 8-11th. We will also demonstrate the QuickAI Module for predictive maintenance and audio applications.

We look forward to seeing you at these events.

Our next conference call is scheduled for Wednesday, February 13th at 2:30 PM Pacific Time.

Thank you for your participation and continued support. Good bye!

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