



## Q2 FY19 Earnings Conference Call Prepared Remarks

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### Operator

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Ladies and gentlemen, good morning. At this time, I'd like to welcome everyone to QuickLogic Corporation's Second Quarter Fiscal Year 2019 Earnings Results Conference Call. As a reminder, today's call is being recorded for replay purposes through August 14, 2019. I would now like to turn the conference over to Mr. Jim Fanucchi of Darrow Associates. Mr. Fanucchi, please go ahead.

### Jim Fanucchi

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Thank you, operator and thanks to all of you for joining us. Calling in from Boston this morning in advance of their appearance at today's Oppenheimer conference are Brian Faith, President and Chief Executive Officer, and Dr. Sue Cheung, Chief Financial Officer.

As a reminder, 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 our 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



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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 most recent annual report on Form 10 K, most recent quarterly report on Form 10 Q, recent Forms 8-K and other documents we periodically file with the SEC. 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.

In today's call we will be reporting non-GAAP financial measures. These non-GAAP measures should not be considered as a substitute for or superior to financials prepared in accordance with GAAP. You may refer to the earnings 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.

Please note, QuickLogic uses its website, the company blog, 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.



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A copy of the prepared remarks made on today's call will be posted at QuickLogic's IR web page shortly after the conclusion of today's earnings call.

I would now like to turn the call over to Brian.

### **Brian Faith** – Chief Executive Officer

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Thank you, Jim. Good morning from Boston everyone and thank you all for joining our Q2 2019 financial results conference call.

A lot has happened since the close of Q2.

Due mostly to recent schedule changes that are outside our control, full-year 2019 revenue is expected to lag significantly behind the outlook we shared last May and reiterated in June.

Our revised 2019 outlook is for total revenue of \$13 to \$13.5 million and non-GAAP gross profit margin in the low 60 percent range. At the midpoint, this projects a total revenue increase of approximately 5%, and a 25% increase in non-GAAP gross profit dollars compared to 2018.

After carefully evaluating our new design wins and the revised production schedules we have received from our customers during the last several weeks, I believe we remain on track to achieve our goal of non-GAAP and cash-flow breakeven in Q1 2020 and profitability for full year 2020.

With the cash we raised in June, we have strengthened our balance sheet to support these goals and I do not expect the need to raise further cash via an offering going forward.



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Just ahead of our June offering, we became aware that our military customers were faced with delays from their end customer. We were initially assured those delays would be resolved quickly and that production schedules would be accelerated resulting in full-year shipments being in line with our previous outlook.

Our sales channel has since confirmed directly with a U.S. Navy Admiral that production will be extended rather than accelerated. This extension reduces our outlook for Q3 and full year 2019 mature product revenue by approximately \$2 million.

The ongoing trade war with China has caused several of our customers to delay new product introductions.

The threat of tariffs on certain Chinese consumer electronics products has disrupted the introduction schedule for one of our largest 2019 design wins. Our lead customer for this design has advised us that its major retail outlets in the U.S. have purchased enough of its current models to take them through the holiday shopping season. As a result, the new models incorporating our EOS S3 for always-on voice control that it had planned to begin shipping in Q3 2019 have been pushed out to Q1 2020.

We have discussed this situation with the consumer company that we worked with to develop the always-on EOS S3 voice control reference design that was the basis for the lead OEM design. Through this we've been advised they will wait for the lead OEM to bring their product to market, which has been given several months of exclusivity.



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Following the release by the lead OEM in Q1, we remain confident the reference design will be used by multiple OEMs across numerous product models during calendar year 2020. While this will clearly benefit us next year, the delayed introduction by the lead OEM reduces our second half and full year 2019 outlook by approximately \$1.3 million.

In the Hearable market, we continue to support production for JD.com, SF Express and a variety of smaller EOS S3 design wins. While we have encountered some new product introduction delays that are attributable to the trade war with China, we finally have a clear path forward for Amazon AVS or Alexa Voice Service compliant hearable designs. With that, and the revised schedules we have received from our customers, I believe revenue generated by hearable designs will ramp significantly beginning in Q4 2019.

Amazon has created two levels of compliance for its hearable specification known as AVS Close Talk. AVS Close Talk Certification is the specification for finished devices. Passing Certification testing enables a finished device to be branded as AVS Close Talk compliant.

We believe the first finished device using EOS S3, which was submitted to Amazon last Friday, will pass the Certification test later this month and be displayed by Amazon at the September [IFA Conference in Berlin](#). To the best of our knowledge, this will be the first in-ear hearable device that is Certified by Amazon to be branded as AVS Close Talk compliant.

A level up from Certification, and with much more stringent criteria, is AVS Close Talk Qualification. This is the standard that reference designs must meet in order to be included on the Amazon AVS Development Kit web page.



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The reason this test is more stringent is Amazon wants to ensure that a qualified reference design has enough guard-band to enable new product designs to easily pass AVS Close Talk Certification testing.

Several months ago, we partnered with Retune DSP, which is the only Voice processing software that has been awarded AVS Close Talk Qualification.

We have since ported the Retune DSP VoiceSpot wake-word software to EOS S3 and confirmed with our internal testing that it meets AVS Close Talk Qualification requirements with only one microphone. As a result, our customers that have one mic designs should be able to move forward with Certification testing once they port the Retune software to their designs.

We have been working closely with one of the world's largest hearable manufacturers to develop a complete and turnkey reference design using EOS S3 running Retune DSP software. We anticipate that design will be completed and delivered to Amazon for AVS Close Talk Qualification testing by the end of Q3. If successful, this reference design will be included on the Amazon AVS Development Kit web page.

In addition to Retune DSP, we have also formalized a partnership with Nuance Communications and ported its widely used wake word and voice command technology to EOS S3. Nuance has been involved in voice processing software for over two decades and has a wide user base with particularly good penetration in China.



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While the delays we have encountered in the hearable market reduce our 2019 outlook by approximately \$1.2 million, we believe we finally have a clear path for our customers that are targeting AVS Certification for their products. With this, we believe hearable revenue will accelerate beginning in Q4 2019.

Beyond the hearable market, we continue to support the Cleer voice-enabled Bluetooth® speaker. As Cleer continues its expansion into European markets, we are optimistic that we'll see higher volume requirements for it in the second half of 2019.

In June we announced a new Integrated Alarm System or IAS reference design from Infineon that targets home, commercial and industrial IoT applications. The Infineon IAS addresses the growing problem of false alarms by processing inputs from sound and pressure sensors. With this, the system can differentiate between noises from TVs or maybe a pet as opposed to a real event like an intruder breaking a window or opening a door.

IAS can be implemented as a standalone product or integrated into a variety of multi-function IoT devices. A number of well-known consumer product companies are currently evaluating the IAS reference design for integration into their products.

Similar to the strategy used for Wi-Fi and camera modules, a large module manufacturer has already designed a new low-cost module based on the Infineon IAS that OEMs can easily integrate into finished IoT designs. This module is scheduled for introduction before the end of 2019.



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We recently established a partnership with Atmosic, which is rapidly developing traction for its new ultra-low-power Bluetooth Low Energy or BLE solution. Leveraging this and our new partnership with Retune DSP, we have already won a new design with a large consumer electronics OEM for a voice-enabled TV remote control.

This design is scheduled for release in December 2019 and is forecasted to ship several hundred thousand units in 2020. We are engaged with this customer on a second design that has significantly higher volume potential that is scheduled to launch in 2020.

I'm very pleased to confirm the Japanese smartphone OEM that we signed a broad MOU with in 2018 has designed our EOS S3 into four smartphones and one feature phone so far.

We shipped a modest quantity of EOS S3 to this customer during the first half to support pre-production builds of the first smartphone, which is scheduled for release by a Japanese carrier later this month. Following that release, we expect production will ramp during the last four months of 2019.

The release schedule for the next three smartphones has been extended to late Q4 2019. The feature phone, which we expect will have two to four times the average annual volume of the smartphones, is currently scheduled for release in Q2 2020. These release schedule adjustments lower our second half and full year 2019 outlook by approximately \$900 thousand.

In eFPGA, we finalized a license agreement with a prime military contractor in Q2 that has been commissioned by the DoD to evaluate and recommend embedded FPGA solutions and suppliers.





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Military contractors already represent a large market for discrete FPGAs and the DoD is taking steps now that will make it easier for its contractors to incorporate embedded FPGA in ASIC designs. We are optimistic the evaluation of our solution will be favorable and with that, help us close one of our ongoing engagements with a DoD contractor and lead to new opportunities for our embedded FPGA IP with other contractors.

We had expected to finalize testing of the ETH Parallel Ultra-Low Power IC that includes our eFPGA IP last quarter. However, given the travel and vacation schedules of key people from ETH, the qualification is ongoing. We expect the qualification to be completed during Q3.

We are very close to signing a new MTLA with a semiconductor company and believe we are on track to finalizing a license agreement with another company during Q4. As we've discussed in the past, the MTLA generates only modest revenue, but enables us and the customer to fast-track SoC License Agreements that generate considerably more revenue.

In the broader picture, we have engaged with quite a few OEMs and Semiconductor companies that would like to license our eFPGA IP but want us to modify it to suit their application and use case. The challenge here is the requested changes require what is often a significant R&D investment from QuickLogic that is unlikely to be leveraged to other opportunities.

While some of these opportunities could work out well if the company develops an SoC or ASIC that moves into high volume production, we have determined the risk of that, and lack of leverage is not the best investment of our R&D resources.



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Due to that, we are in the process of building out a more scalable go-to-market strategy that leverages the relationship and technology of some of our key partners. We look forward to providing details on this in the coming months.

At the bottom line, the balance of these puts and takes lowers our second half and full year 2019 outlook for eFPGA by about \$600 thousand but positions us for what we believe will be a very significant upside for eFPGA IP revenue beginning in early 2020.

Let's shift now to wrap up with QuickAI and SensiML.

Late in 2018 we launched a QuickAI Multi-chip Module, or MCM, initiative to accelerate our penetration into certain AI Vision markets. We have since decided that it will not provide us with the ROI or leverage of our key resources that we originally envisioned.

There are several reasons behind this decision:

First, The SensiML Toolkit provides us with unique competitive advantages in the time series AI market, and with the rapid advancements made by SensiML, a significantly larger share of the time series AI market than we thought can be addressed with standard microcontroller architectures.

Second, the emerging markets that can benefit from leveraging time series data to implement AI are much larger than we originally imagined, and with the enabling power of the SensiML Toolkit, many customers within these markets are ready to initiate development efforts now.



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Third, the initial gross profit margin for MCMs appeared to meet our model in the mid 60% range. However, as we got deeper into the development and market research, we determined the required ongoing R&D investment to customize modules for various AI vision use cases, and the fact we didn't own all the silicon in the module, would likely drag the margin significantly below our target model over time.

Due to these considerations, we have decided to shelve the QuickAI MCM initiative. While it may have generated as much as \$2 million in revenue this year, we determined the potential upside does not properly offset the high capital investment, high risk of declining margins and the fact it was outside the time series AI markets we are seeing success with SensiML today.

SensiML continues to gain momentum. SensiML closed Q2 with a total of 12 SaaS customers; 4 of which are Global Fortune 500 companies. This is up from only 3 SaaS customers at the end of Q1.

We believe SensiML will close Q3 with 25 to 35 SaaS customers, and with that, increase its penetration into the Global Fortune 500.

While I recognize it is a very broad range, we believe SensiML will close 2019 with a total of 50 to 100 SaaS customers and realize its objective of cash flow and non-GAAP profitability.

We are particularly excited about a new Global Fortune 500 SaaS customer that has committed to developing a proof of concept design to implement time series AI at the edge of factory automation. In this case the customer's target is to develop a very small module



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that can be attached to motors and collect time series data for real-time predictive maintenance on factory floors.

While we are not able to provide you with additional color at this time, SensiML has also taken some major steps that are designed to establish its Toolkit as the de facto development tool for end-point time series AI.

Before I turn the call over to Sue, I would like to take a moment to acknowledge Don Alexander, our new VP of Sales. Don has broad-based FPGA experience, a history of closing major deals and excellent relationships throughout the channel that are key to our long-term strategy. We are very proud that he decided to join the QuickLogic team.

I would now like to turn the call over to Sue for a discussion of our recent financial performance and Q3 Outlook. Sue:

**Dr. Sue Cheung**– Chief Financial Officer

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Thank you, Brian. Good morning and thanks to everyone for joining us.

For the second quarter of fiscal 2019, total revenue was \$2.1 million, which was within the revised guidance range of \$2.0 to \$2.4 million that was included in our Form 8K filing on June 18<sup>th</sup>. This compares with revenue of \$3.1 million in the second quarter last year.

Of the \$2.1 million in Q2 revenue, sales of new products were \$700 thousand. This compares with \$1.6 million in the second quarter last year. This decline was primarily due to a significant decrease in low margin connectivity and display bridge sales that were not fully offset by increased revenue from strategic new product sales.



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Our mature product revenue was \$1.4 million, a slight decrease when compared with \$1.5 million in Q2 last year.

In the second quarter we had 2 customers each accounting for 10% or greater of sales.

Gross margin in Q2 was 49.8%, compared with 50.1% in the same quarter last year. The gross margin was impacted by unabsorbed manufacturing overhead from low revenue.

Operating expenses for Q2 2019 were approximately \$4.8 million, compared with \$4.5 million in Q2 2018. Within our Q2 2019 OpEx, R&D expenses were \$2.7 million and SG&A expenses were \$2.1 million. This compares with \$2.2 million and \$2.4 million, respectively, in Q2 2018. The increase in R&D expenses was mostly due to additional engineers acquired from SensiML earlier this year.

The net total for other income, expense and taxes in Q2 was a \$101,000 expense, compared with a \$233,000 benefit in the second quarter last year.

Net loss in Q2 was \$3.8 million, or \$0.04 per share. This compares with a net loss of \$3.0 million, or \$0.04 per share in the second quarter last year.

Now turning to the balance sheet for Q2:

The total cash at the end of Q2 was \$28.2 million. The main changes in cash were the net proceeds of \$8.3 million from the public offering, less the approximately \$3.5 million cash usage in the quarter. Our cash balance at the end of the second quarter also includes the \$15 million draw from the bank revolving line of credit.



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Moving to our forecast for the third quarter of fiscal 2019, which will end on September 30<sup>th</sup>:

Our revenue guidance for the third quarter of 2019 is \$2.1 million, plus or minus 10 percent. We believe total revenue will be comprised of approximately \$1.0 million of new product revenue and \$1.1 million of mature product revenue.

With our guidance for sequentially flat revenue, we currently believe our non-GAAP gross margin will be approximately 51 percent, plus or minus 3 percent. As was the case for Q2, our gross margin will be impacted by unabsorbed manufacturing overhead due to low revenue.

We are forecasting non-GAAP operating expenses of approximately \$5.2 million, plus or minus \$300 thousand. Within OpEx, we expect our non-GAAP R&D to be approximately \$3.1 million and SG&A to be approximately \$2.1 million.

The \$400 thousand increase in total operating expenses from Q2 is due primarily to the timing of engineering consulting expenses and one-time costs associated with the recent move of our headquarters to San Jose. We believe total OpEx expenses will decline to the high \$4 million range starting in Q4 as these one-time expenses roll off and we begin to benefit from the lower cost of our new facility.

After interest expense, other income and taxes, we currently forecast our non-GAAP net loss will be approximately \$4.2 million, or \$0.04 per share based on approximately 116 million shares.



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The primary difference between our GAAP to non-GAAP results is our stock-based compensation expense, which we expect to be approximately \$750 thousand. We expect our stock-based compensation expense will remain in this mid \$700 thousand range for the foreseeable future.

Finally, in Q3, we expect to use between \$3.8 and \$4.2 million in cash. Our expected cash usage will be impacted by low revenue and an anticipated increase in working capital. As a reminder to what I said in our last call, the move to San Jose is expected to be net neutral to cash in 2019, and lead to an annual savings of approximately \$500 thousand starting in 2020. We currently expect our Q4 cash usage will decline by more than 50% from Q3.

Before handing the call back to Brian, I do want to mention that Nasdaq granted us a 180-day extension, through January 13, 2020, to regain compliance with its minimum bid price requirement. This news was included in the SEC Form 8-K we filed on July 18<sup>th</sup>.

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

**Brian Faith** – Chief Executive Officer

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Thank you, Sue.

As we entered July, we faced a rapid succession of schedule adjustments from customers that we expected would driver our revenue growth in 2019. Following this, we met with these customers to ensure the programs remained solid and reaffirm the new schedules we were provided.



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With the information we've received from our customers, we are significantly more confident in our belief that we will report breakeven operations on both a cash and non-GAAP basis for Q1 and achieve non-GAAP profitability for full year 2020.

We have carefully modeled our cash usage en route to these goals and hold the firm opinion that we will not need to raise additional money through a public stock offering going forward.

While the tally of the delays, and impact of our decision to move away from QuickAI MCMs, totals approximately \$8 million, some of that was a guard band above our previous outlook for 2019 and we expect some of it will be offset by new design wins that were not included in that outlook.

As a result, and after a careful evaluation of the data, we have adjusted our 2019 revenue outlook to between \$13 to \$13.5 million.

We believe mature product revenue will be relatively flat with last year and that new product revenue from connectivity and display bridge designs will be about \$200 thousand lower than the outlook we shared in May. We believe other new product revenue will offset that decline and provide us with modest full year revenue growth.

With this mix, we are currently modeling our full year 2019 non-GAAP gross profit margin in the low 60 percent range. This would represent approximately ten percentage points higher than what we reported for 2018.





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Let me take a moment to share what gives us confidence in our ability to rebound from our mid-year low and achieve the goals I have outlined.

We believe production demand from our military contractors will rebound in Q4 and hold through at least 2020; possibly much longer.

By the end of Q4, we believe we will have four smartphones running in production. We believe volume will ramp for these four smartphones beginning in Q1 2020 and that the feature phone, which is forecasted to have two to four times the average volume of the smartphones, will enter production in Q2 2020.

The schedule we have from our large consumer electronics customer indicates it will ramp production of its first models in Q1 2020 and as additional OEMs introduce voice control, we believe aggregate volume will increase throughout 2020.

With the anticipated completion of our first Amazon AVS Close Talk Certified design this month and an AVS Close Talk Qualified reference design being listed on the Amazon Development Kit web page later this year, we believe hearable demand will increase significantly in Q4 and accelerate moving forward.

We believe the first of what could be several voice-enabled TV remote controls incorporating EOS S3 will enter production late in Q4 and we expect production will begin ramping in Q1 2020.

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We also believe the module based on the Infineon IAS reference design will be in production late in Q4. However, since we don't have any detail beyond that, revenue from this design win would be an upside to our near-term outlook.

We are in the process of enhancing our core eFPGA technology and applying a more scalable go-to-market strategy that leverages the relationship and technology of some of our key partners.

We do not want to tip our hand to our competitors, but since these changes will address key concerns that have delayed license deals in 2019, we think they will lead to a sharp ramp of eFPGA IP revenue in 2020; possibly beginning as early as Q1. We also believe we are on course to win one significant license agreement during Q4 2019.

Moving from only three SaaS customers at the close of Q1 to 12 at the close of Q2 and with solid penetration into Global Fortune 500 companies, SensiML is clearly building impressive momentum. We believe this trend will accelerate in the second half of 2019 and continue for years beyond that.

I'll readily admit that SensiML's goal of becoming the de facto software Toolkit for end-point AI may seem ambitious at this stage; however, we think it is a very realistic and achievable target. We look forward to releasing more information about our progress towards this goal during the coming months.

While we are not ready to share a full year 2020 outlook, the mix of business we see today gives us confidence that we will not only significantly increase revenue, but again deliver a



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solid increase in our non-GAAP gross profit margin for the fourth straight year, and with that, report non-GAAP profitability for full year 2020.

That completes our prepared remarks. Operator, I would now like to open the call for questions.



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**Brian Faith** – Chief Executive Officer

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### Post Q&A

We will be participating in several investor and industry events this quarter. A few of the highlights include:

- Oppenheimer Annual Technology, Internet & Communications Conference in Boston today
- The Jefferies Semiconductor, Hardware and Communications Infrastructure Summit in Chicago on August 28
- The Gateway Conference in San Francisco on September 4
- GlobalFoundries Technology Conferences in Santa Clara on Sep. 24, Munich on October 11, Shanghai on October 24 and Hsinchu, Taiwan on November 5.

All the events we plan to attend will be available on the Events Section of our website.

Thank you for your participation in today's call and continued support. We look forward to speaking with you again when we report our fiscal third quarter results later this year.

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