Q2 FY20 Earnings Conference Call Prepared Remarks

Operator

Ladies and gentlemen, good afternoon. At this time, I would like to welcome everyone to QuickLogic Corporation's Second Quarter Fiscal Year 2020 Earnings Results Conference Call. As a reminder, today's call is being recorded for replay purposes through August 12, 2020. I would now like to turn the conference over to Mr. Jim Fanucchi of Darrow Associates. Mr. Fanucchi, please go ahead.

Jim Fanucchi

Thank you, operator and thanks to all of you for joining us. Our speakers today are Brian Faith, President and Chief Executive Officer, and Dr. Sue Cheung, Chief Financial Officer. In line with social distancing practices, management is doing this call from remote locations today.

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 the number of our ecosystem partners; and expected results and financial expectations for revenue, gross margin, operating expenses, profitability and cash.

Actual results or trends may differ materially from those discussed today. For more detailed discussions of the risks, uncertainties and assumptions that could result in those differences, please refer to the risk factors discussed in QuickLogic's most recently filed periodic reports with the SEC. QuickLogic assumes no obligation to update any forward-looking statements or any new information or future events.

In today's call we will be reporting non-GAAP financial measures. 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 business. Such information may be deemed material information, and QuickLogic may use these channels to comply with its disclosure obligations under Regulation FD.

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

Thank you, Jim. Good afternoon, everyone, and thank you all for joining our second quarter fiscal 2020 financial results conference call.

I would like to start by recognizing the tireless efforts of our talented QuickLogic team as we've rapidly adapted and responded to a new working environment during this COVID-19 pandemic period. This has been a challenging period for our team both personally and professionally and I appreciate their commitment.

With that as a starting point, there were three key events that were announced in the second quarter that will have positive implications on our business in the future.

First, on June 16 we announced the QuickLogic Open Reconfigurable Computing, or QORC, initiative. This project, which was developed in collaboration with Google and Antmicro, broadens access to our EOS S3 SoC, our FPGA technology and eFPGA IP for all embedded systems developers. We are the first programmable logic vendor to actively embrace a fully open source suite of development tools for its FPGA devices and eFPGA technology.

QORC is an important milestone for us. Many industry observers have commented in recent years that the Programmable Logic industry is at a transition point. While it remains multi-billion dollars in size, the growth is expected to be at a moderate pace of around 7% per year over the coming five years.

However, the open source RISC-V IP, software and tools market is predicted to grow at nearly 7 times that of the FPGA Market rate. Given the changing landscape, we are aggressively redeploying our resources to make open source the primary foundation of our business going forward.

The second significant event is the announcement that SensiML is collaborating with a consortium of companies, universities, and health organizations to help predict whether people are showing symptoms of COVID-19 infection. The goal of the initiative is to give businesses, governments, healthcare, and other public facilities access to multi-sensor, pre-diagnostic screening mechanisms to help slow the spread of the disease. The consortium includes Asymmetric Return Capital, Linear ASICs, SkyWater Technology, Upward Health, and others. We recently executed our first SaaS agreement associated with this initiative, expect the initial product launch before the 2020 flu season starts and to realize a more meaningful financial impact in Q4 of this year.

The third significant event was the completion of our oversubscribed secondary, which in total raised net proceeds of approximately $8.1 million. We felt it was prudent to raise money at this time to make sure we had the financial strength to support our open source product plans and growth initiatives.

It was a busy second quarter, but one I believe will, over time, be viewed as a pivotal moment in the transformation of QuickLogic.

With those important items as a primer, I want to spend some additional time on the open source initiative and then review other items from the quarter.

The QuickLogic Open Reconfigurable Computing Initiative, I have spoken about at a high level in recent months is expected to be a catalyst for QuickLogic's future growth. The initiative, developed by QuickLogic in collaboration with Google and Antmicro, broadens access for embedded systems developers to use our FPGA technology and eFPGA IP.

For some background, the open-source hardware movement has established a solid foothold after multiple attempts that yielded only limited success, even for processors. With demand for more customized hardware, and a growing field of startups looking to build accelerators and solutions highly tailored to AI/ML algorithms, interest in open-source hardware has been rising.

In fact, there are now a growing number of new developers with software backgrounds gravitating towards open source FPGA development tools, including design teams at some of the largest companies in the electronics industry.

We are already seeing traction with the QORC initiative. You may remember in recent earnings calls I alluded to the initiative being co-developed with a mega cap company. For disclosure reasons we were not able to mention Google by name until the June news release. What started as a conversation with a Google open source visionary transformed into an entire open source initiative for QuickLogic. Once we decided to move all-in into open source, we knew we needed our efforts to address much more than just FPGA tools. This was the thought process that led to the QORC initiative. Our website contains additional background material if you are interested in learning more.

The rate of adoption is ramping quickly. In early July, QuickFeather was launched with Crowd Supply, one of the leading online companies to launch and fulfill demand for innovative open source hardware development kits. In just one month we have already received orders for more than 100 kits and expect this pace to accelerate as we expand our network of channel partners to ship more QuickFeather dev kits into the market.

Based on this better than expected interest, and following the roadmap we have in place, I am confident we will achieve our goal to get at least a thousand of these dev kits into the market by the end of 2020. Over time, we expect product wins leveraging QuickFeather will drive more revenue opportunities for our EOS S3 and SensiML AI software.

Since we are just in the initial stages of QORC it is too early for me to quantify the near-term revenue impact this year. However, we are executing on a go-to-market plan using multiple channels and could see few to several million dollars in potential EOS S3 revenue and multiple eFPGA IP licenses next year directly related to the QORC initiative.

To further demonstrate the breadth of opportunities our QORC initiative can lead to, our team recently engaged with a product team that is developing a new range of home computing devices for their 2021 holiday launch. While it is very early to discuss any potential long-term relationship, this should be viewed as a sign of early market acceptance of the QORC initiative.

Other parts of our business are starting to settle after a challenging few months since the COVID-19 pandemic took hold. Starting with our SensiML COVID-19 initiative - the previously announced consortium is currently readying a health monitoring solution that includes a low-cost body-worn temperature sensor and smartphone-based app that combines a variety of biometric data and AI software. The solution is also intended to allow integration with contact tracing applications such as the exposure notification apps available through the Apple and Google Play App Stores. We are talking with potential customers about using this application for screening at public venues, safe re-opening of workplaces, and healthcare test access.

In addition to the COVID-19 application, SensiML has completed two major developments since our last conference call. First, the integration with ST Micro's new SensorTile.box development kit is now complete. This will result in an expansion of the co-marketing and co-selling activities with one of the largest MCU companies in the world.

Second, SensiML is releasing an update of its SensiML Analytics Toolkit that adds support for Google's open-source machine learning framework called TensorFlow Lite for Microcontrollers. Together, SensiML and TensorFlow Lite, or TFL, complement each other by offering powerful TFL neural network algorithm execution along with an established AI tool. The openness, flexibility, and performance enabled by this effort is important and valued by our MCU partners and IoT device customers and will be a key enabler for our SaaS-related revenue growth in the coming quarters.

With an improving SensiML hit rate, greater partner outreach, and Google TFL integration in place, our focus remains on driving towards scalable growth.

In our new product segment, supply chain delays and the challenges imposed by customer hardware teams working remotely had a significant impact on this part of our business. We are seeing improvement in the global supply chain, but that is somewhat counterbalanced by the fact that due to the disruptions earlier this year, several product launches that were expected in the Q2/Q3 timeframe have been moved to later this year or calendar 2021. This includes several voice-enabled consumer products.

Within our smartphone business, Kyocera had a very strong quarter due to a combination of increased end-market demand and their decision to build inventory from all suppliers to mitigate potential supply chain issues. This greater than expected surge increased our test costs in the quarter, which negatively impacted our gross margin performance in Q2.

We expect to see lower sales to Kyocera during the third quarter as they digest this inventory for current models ahead of new phone launches anticipated later this year. We are nearing completion of our next smartphone design, and I remain confident we could see as many as six phones using our technology, up from three at the beginning of the year.

In the hearables market, we are on track to achieve formal Amazon AVS certification this quarter and hope to see a new hearable product enter the market before the end of the year and ship several hundred thousand dollars of EOS S3 within 2020.

In our eFPGA IP business, we are delivering our final netlist this week to one of our early engagements for a tape-out of their test chip. If all goes well with their chip manufacturing and validation, we could see a full eFPGA IP license between Q4'2020 and Q1'2021.

Last quarter, I discussed how COVID related delays directly impacted a program with a well-known and fast-growing streaming and smart TV provider to get a voice activated remote control to market. We were able to realign our efforts with a low power digital microphone company and are targeting to launch a new reference design later this quarter. While the volumes will be smaller than the prior program, the introduction of this reference design is another reminder that the trend for greater adoption of hands-free remote controls is accelerating.

Within our mature segment, COVID-19 continues to have a significant impact on this part of our business. Ongoing manufacturing shutdowns and the reduction in consumer air travel has caused a dramatic drop in the civilian aerospace market. Based on customer forecasts received in the last two weeks, we expect to see mature revenue dip again in the third quarter, to a level similar to what we saw in Q3 last year, before growing in Q4 of this year.

Because of this recent change, we are reducing our second half 2020 mature product revenue forecast by another $2 million from our expectations discussed in the May conference call.

To summarize, in spite of the many COVID-19-related headwinds we have faced this year, I want to emphasize that I am as optimistic as ever about our future. Fiscal 2020 has been more challenging than anyone could have imagined back when we held our February conference call. However, the positive signs we are already starting to see with our open source initiative and SensiML TFL initiatives with Google, coupled with what our customers believe will be improving conditions by year end, gives me confidence that we now have a defined path to improved financial performance starting in the fourth quarter.

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

Dr. Sue Cheung– Chief Financial Officer

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

For the second quarter of fiscal 2020, revenue was $2.2 million, which was within the updated guidance range of $2.3 million plus or minus 10%, that was included in our SEC filing on June 17th. This compares with revenue of $2.1 million in the second quarter of 2019.

Within our Q2 revenue, sales of new products were $820,000. This compares with $711,000 in the second quarter of 2019. Our mature product revenue was $1.4 million, which was the same as Q2 last year.

In the second quarter of 2020, we had three customers who each accounted for 10% or greater of our sales.

Non-GAAP gross margin in Q2 was 47.1%, compared with 49.8% in the same quarter of fiscal 2019. The lower gross margin in the second quarter was mainly due to additional test costs to support the higher volume of products shipped to our primary smartphone customer.

Non-GAAP operating expenses for Q2 were approximately $3.2 million, down more than 30% from $4.8 million in the second quarter of last year. Through continued streamlining of our operations we believe operating expenses will trend lower through the remainder of fiscal 2020.

Within our Q2 operating expenses, R&D was approximately $1.7 million, and SG&A was approximately $1.4 million. This compares with R&D and SG&A of $2.7 million and $2.1 million, respectively, in Q2 last year.

The net total for other income, expenses, and taxes in Q2 was a charge of $84,000, compared with $101,000 in the second quarter last year.

Non-GAAP net loss in Q2 declined to $2.2 million, or $0.26 per share. This compares with a net loss of $3.8 million, or $0.54 per share in the second quarter of last year. The per share calculation for both periods reflects the one-for-fourteen reverse stock split that was executed last December.

The total cash at the end of Q2 was $26.4 million, compared with $19.0 million at the end of last quarter. The Q2 cash balance includes the net proceeds from the stock offering and the funding from the PPP loan. It does not include the approximately $461,000 in net proceeds from the exercise of the overallotment that closed in July. Our cash balance also includes the $15 million draw from the revolving line of credit. When factoring out all external funding that I just mentioned, our Q2 cash usage was $1.8 million.

Now moving to our forecast for the third quarter of fiscal 2020, which will end on September 27th:

Our revenue guidance for the third quarter is $2.0 million, plus or minus 15%. As Brian discussed, given the evolving conditions due to COVID-19 and its impact on our customers and suppliers, we are widening the revenue range at this time. At the midpoint, we believe total revenue will be comprised of approximately $700,000 of new product and $1.3 million of mature product.

With a more diversified product mix, Non-GAAP gross margin in the third quarter will be approximately 55%, plus or minus 5%.

As a result of our continuous cost control measures, we are forecasting non-GAAP operating expenses will decline further and be approximately $3.1 million, plus or minus $300 thousand. We expect this to be a normalized level for the next few quarters. At the midpoint of the Q3 range, R&D should be $1.8 million and SG&A $1.3 million.

After interest expense, other income and taxes, at the midpoint, we currently forecast our non-GAAP net loss will be approximately $2.1 million, or a net loss of $0.19 per share based on approximately 11.0 million shares outstanding.

Most of the difference between our GAAP and non-GAAP results is our stock-based compensation expense. We expect stock-based comp to be in the range of $700,000 for the next few quarters.

Finally, in Q3, we expect cash usage to be in the range of $2.0 to $2.5 million. The anticipated higher cash usage is mostly due to the timing of working capital and the one-time transaction costs associated with the stock offering to be paid in Q3. We expect cash usage to decline in Q4 as both revenue and gross margin improve.

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

Brian Faith – Chief Executive Officer

Thank you, Sue.

To add on to the guidance Sue gave for the third quarter, based on current customer forecasts, our annual outlook has declined another $3 million for the reasons I have discussed in our mature product segment, plus the inventory absorption for our smartphone customer and pushout of voice-enabled hearables. With this change, we now expect our full year 2020 revenue will be approximately flat with Fiscal 2019. While we are disappointed with the near-term outlook, we currently expect our Q4 product mix will have a heavier emphasis on software and IP-related sales. This should increase our Q4 gross margin back into the low to mid 60% range, which in turn should boost our fiscal 2020 gross margin to the high 50s.

COVID has clearly disrupted the path to profitability I laid out at the beginning of the year, but based on the factors I have described, and with our significantly reduced operating expenses, our trajectory to profitability within 2021 looks promising. With the material progress in all of our new product lines, I am confident we have a path to achieve operating income breakeven by the end of the first half of 2021.

In closing, I would like to thank all our stakeholders for their ongoing support. These are extraordinary times for all of us, and we are doing everything possible to maintain a safe work environment while also taking care of our customers who are facing their own challenges.

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

Brian Faith – Chief Executive Officer

Post Q&A

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 in November.