Impinj Fourth Quarter and Year 2016 Earnings Conference Call
Thursday, Feb. 16, 2017
5:00 p.m. ET / 2:00 p.m. PT

MARIA RILEY, INVESTOR RELATIONS FOR IMPINJ

Thank you, Operator. Thank you all for joining us to discuss Impinj's fourth quarter and year 2016 results. On today's call, Chris Diorio, Impinj's Co-Founder and Chief Executive Officer, will provide a brief overview of our performance and market. Evan Fein, Impinj's Chief Financial Officer, will follow with a detailed review of our fourth quarter and year 2016 financial results and 2017 outlook. We will then open the call for questions. Impinj's President and COO, Eric Brodersen, is also on the call and will join Chris and Evan in the Q&A session. Please note that management's prepared remarks, along with quarterly financial data for the last eight quarters, are available on the company's website. Also, we will consider questions received via email prior to the call and will address some of these questions in the Q&A session on this call.

Before we start, note that we will make certain statements during this call that are not historical facts, including those regarding our plans, objectives and expected performance. To the extent we make such statements, they are forward-looking within the meaning of the Private Securities Litigation Reform Act from 1995. Any such forward-looking statements represent our outlook only as of the date of this conference call.

While we believe any forward-looking statements we make are reasonable, our actual results could differ materially because any statements based on current expectations are subject to risks and uncertainties. We do not undertake, and expressly disclaim, any obligation to update or alter our forward-looking statements, whether as a result of new information, future events, or otherwise except as required by applicable law.

Also, during today's call, all statement of operations results, with the exception of revenue, or where we explicitly state otherwise, are non-GAAP financial measures. Balance sheet metrics and cash flow metrics are on a GAAP basis.

Before moving on to the financial results, I would like to note that Evan and Eric will attend the Morgan Stanley Technology, Media & Telecom Conference on March 1st and the Pacific Crest Emerging Technology Summit on February 28th in San Francisco. We hope to see you there.

I will now turn the call to Chris Diorio, Impinj Co-Founder and Chief Executive Officer. Chris.

Chris Diorio, Impinj Co-Founder and Chief Executive Officer

Thank you, Maria. Thank you all for joining the call. I am delighted to be here with you today.

We delivered another record in the fourth quarter of 2016, exceeded our revenue guidance, and closed a successful year that included an IPO and follow-on offering. Fourth quarter revenue grew 49% year-over-year to reach $33.7 million, our best quarter ever, driven primarily by demand for our endpoint ICs. Revenue for the year was $112.3 million, representing 43% growth over 2015.

As we have noted in prior calls, we view endpoint IC volumes as an indicator of RAIN market adoption and are excited by the demand we are seeing. As 2016 progressed, our estimates for 2016 endpoint IC volumes increased significantly, especially in the back half of the year. On our November call we raised our estimate to between 5.6 billion and 5.8 billion endpoint ICs. We closed the year above that prior estimate, shipping 6.0 billion endpoint ICs, for approximately 70% year-over-year growth. As I will discuss in more detail in a few minutes, we expect strong volume growth again in 2017, but more in-line with the predictions of industry analysts than the heightened growth we saw in 2016.

On this call I'd like to briefly review Impinj's vision and mission, then discuss where and how we believe the value proposition and benefits of RAIN and the Impinj platform are driving market adoption, and then close with our strategy to capitalize on that market adoption.

Impinj's vision is digital life for everyday items. Our mission is to wirelessly connect those items to applications. We are literally extending the reach of the Internet by a factor of 100 to everyday items and delivering, to the digital world, each item's unique identity, location and authenticity, which we call item intelligence. Our platform enables that connectivity and delivers that item intelligence to business and consumer applications.

To give you a better sense of the value proposition and benefits of the Impinj platform, I would like to start with some personal observations. I attended the National Retail Federation (NRF) show in New York a few weeks ago, for the third consecutive year in which Impinj had a booth at NRF. For me personally, the differences between our first show, in January 2015, and this show in January 2017 are striking. Back in 2015 we had just closed a year in which we delivered 2.3 billion endpoint ICs. The RAIN Alliance was a mere eight months old; the RAIN name was mostly unknown; Impinj hadn't yet announced our ItemSense software, and our ability to identify and locate items, like apparel and jewelry, was so surprising to end-users that several returned to the booth multiple times, bringing others, to see our demonstrations. Fast forward to this year's NRF and our annual endpoint IC volumes have grown 156% to 6.0 billion ICs in 2016; the RAIN Alliance has more than 125 member companies, and this time end-users returned to our booth to ask how Impinj and our platform can improve inventory visibility, enhance customer experiences and enable omnichannel fulfillment. That's not to say we didn't also show new advancements, in fact, during the show, I carried a Lenovo Moto Z phone that included a prototype, demo-only RAIN reader Mod coupled to the phone. We also showed multiple in-booth demos, including a tutorial on our McDonald's solution, an item-locationing solution with Deloitte, and an Impinj platform-enabled Coke Freestyle soda fountain. But this time it was me who was surprised, mostly by the intensity of the end-user needs and requests. We and our partners are focused on addressing those needs and requests, significantly in the form of joint solutions that we productize and bring to market.

For example, in the fourth quarter of 2016 we announced a joint solution with Oak Labs on an interactive, retail fitting-room mirror that synchronizes with a retailer's inventory system and online catalog. The mirror recognizes items a customer brings into a fitting room, shows available sizes and colors, recommends related items, has a button to call an associate, and allows customized room lighting and language settings. Oak Labs has announced installations at select Ralph Lauren and Rebecca Minkoff stores.

Of course, retail isn't the only industry adopting RAIN and the Impinj platform. Next week we will attend the HIMSS healthcare conference in Orlando, one of the largest healthcare events, fresh off the heels of two joint healthcare solutions we announced in the fourth quarter of 2016.

The first, with Terso Solutions, is a mobile, RAIN-enabled hard case that enables automated field inventory management, eliminating product loss and reducing late invoices by integrating field transactions into existing enterprise resource planning and inventory management systems.

The second, with VUEMED, embeds FDA-required data, including product information like manufacturer name, batch, serial number, and expiration date into medical items and tracks the items from manufacturer to patient. It then links the data to the hospital's administrative systems and the patient's electronic health record, allowing hospitals and manufacturers to identify the items' location and inventory details. By identifying and tracking a hospital's medical supplies and items, it improves point-of-use visibility and data integration into billing and enterprise resource planning systems.

I will introduce a panel discussion Tuesday, February 21st at HIMSS. The panelists include customer experts from healthcare organizations like the Memorial Sloan Kettering Cancer Center, the Medical University of South Carolina, Inova Fairfax Hospital and the Veteran's Administration. The panelists will share their experiences driving improvements in asset and supply management using solutions from our partners integrated with our platform.

Overall, we introduced 12 joint solutions in 2016, four in retail, seven in healthcare, and one in logistics. We also received five awards in 2016, notably the IoT Evolution 2016 Asset Tracking Award, the IDTechEx Best IoT Technology Development Award and the Fierce Innovation Award in Healthcare. Finally, we closed the year with 201 issued patents, three allowed applications, and 39 pending applications.

Returning to endpoint ICs, we achieved record volumes, especially in the back half of 2016, that were well above our expectations and industry forecasts. We believe our 2016 unit-volume overachievement was due to us securing some special end-user and competitive wins that will continue driving 2017 unit volumes, but we are not counting on additional special events in 2017. Consequently, we expect our 2017 unit-volume growth rate to be more in-line with our six-year CAGR and with the market growth expectations of RAIN industry analysts. We currently estimate we will sell between 7.8 and 8.0 billion endpoint ICs in 2017, representing 32% growth over 2016 at the midpoint.

In large part because of the unit-volume overachievement, endpoint ICs grew to a larger portion of our total revenue in 2016 than in 2015. Looking forward to 2017, we expect the fraction of our total revenue attributable to connectivity and software to increase as we realize the benefits from the significant investments we made in connectivity and software in 2016, and as we continue to gain traction with our systems-selling motion. Over time, we expect the total revenue attributable to each layer of our platform to realign with our long-term model.

As we look to 2017 and beyond, we will continue investing in four key strategic areas: platform, ubiquitous reading, verticals expansion and joint solutions. At the same time, we will concentrate on what sets Impinj apart from others in our market: customer focus, products, operations, quality and, most importantly, our employees and their dedication to our success.

Focusing just on our platform for a moment, we will continue making significant R&D, marketing and sales investments in technology, performance and ease-of-use. Our platform abstracts away the complexities of RAIN technology and allows end-users to leverage our know-how and realize benefits quickly. Its breadth and scale are unmatched in the industry. For example, at the connectivity layer, in 2016 we introduced our xSpan gateway for monitoring items passing through portals or along corridors. As another example, at the endpoint layer, we've sold more than 18 billion endpoint ICs from our inception thru the end of 2016, more than half of those, 9.5 billion, between Jan. 1, 2015 and Dec. 31, 2016.

We ended the year with 245 employees and 39 open positions, the latter spread across the company. We also have occasional departures, including sometimes from our senior leadership team. On February 10, Walter Palhetas and Impinj mutually agreed that Walter would step down from his position as Senior Vice President of Sales, in part for him to focus on personal priorities. We thank Walter for his key contributions during a critical growth period for the company. Walter will assist the company with transition activities through April 15. Eric Brodersen, Impinj's president and COO, will take direct responsibility for the sales organization. We expect Eric's strong sales background to serve us well as Impinj continues to scale and grow. As always, we will monitor and reevaluate these and other reporting relationships as needs arise, focusing on how to best grow and scale the company.

In summary, 2016 was a great year from a company, market and sales perspective. As we look ahead to 2017, we are incredibly excited about the growth opportunity ahead of us and how well-positioned Impinj is to capitalize on this massive market opportunity.

I will now turn the call over to Evan to give you a detailed look at our 2016 financial results and our outlook for 2017. Evan.

Evan Fein, Impinj Chief Financial Officer

Thanks, Chris. Before I review our fourth quarter and year 2016 financial results I want to remind you that with the exception of revenue, or unless explicitly stated otherwise, today's statement of operations information is on a non-GAAP basis. All balance sheet and cash-flow metrics are on a GAAP basis. A reconciliation between our non-GAAP and GAAP measures, as well as how we define our non-GAAP measures, is included in our earnings release available on our website.

As Chris mentioned, the fourth quarter brought another record and a strong close to a landmark year that included both robust growth and margin improvement.

Revenue in the fourth quarter grew to $33.7 million, ahead of our guidance and representing 49% growth over the fourth quarter of 2015. That growth was driven primarily by increasing demand for our endpoint ICs. For the full year, we grew revenue 43% to reach $112.3 million. Our endpoint IC volume for the year grew to 6.0 billion, roughly a 70% increase over the prior year's 3.5 billion, which brings our 2010 to 2016 endpoint IC volume CAGR to 36%.

Our gross margin for the fourth quarter increased to 55.6%, compared with 53.6% in the prior quarter and 54.4% in the fourth quarter of 2015. The sequential 200 basis-point increase was primarily the result of new product adoptions, such as Monza R6, and increased software revenue in the quarter. As a reminder, our gross margin can fluctuate from quarter to quarter, and is seasonally lower in the first half of the year as new annual pricing becomes effective.

Commensurate with our plan to invest in the market opportunity, total operating expense in the quarter increased $1.9 million to reach $16.3 million, or 48.5% of revenue, compared with $14.4 million, or 46.4% of revenue in the prior quarter. R&D expense was $6.6 million, or 19.5% of revenue. Sales and marketing expense was $5.8 million, or 17.2% of revenue. G&A expense was $4.0 million, or 11.8% of revenue.

GAAP net income for the quarter was $103,000, and for the year, we reported GAAP net loss of $1.7 million. On a non-GAAP basis, we achieved fourth quarter net income of $2.2 million, or earnings of 11 cents per share, using a weighted-average diluted share count of 20.7 million shares. And for the full year, we achieved non-GAAP net income of $3.7 million, or earnings of 22 cents per share, using a weighted-average diluted share count of 16.8 million shares.

We delivered $2.4 million in adjusted EBITDA in the quarter, or 7.2% of revenue. As we have said previously, we plan to incrementally increase our investment level to enhance our leadership position and capitalize on the massive market opportunity. Adjusted EBITDA for the full year totaled $5.1 million, or 4.6% of revenue.

Turning to the balance sheet, we ended the quarter with cash and cash equivalents and short-term investments of $100.5 million. Our cash balance includes approximately $39 million in net proceeds from our follow-on offering that closed in December. Accounts receivable decreased slightly on a sequential basis to $17.4 million. Consistent with our plan to build inventory to meet increased customer demand, inventory increased by $7.2 million, bringing the balance to $27.7 million. Working capital increased to $123.1 million from $85.2 million in the previous quarter.

Turning now to our outlook, we expect revenue for the first quarter of 2017 to be in the range of $30.0 million to $31.5 million, reflecting 43% year-over-year growth at the midpoint of the range. We expect adjusted EBITDA to be in the range of a loss of $1.0 million to income of $0.5 million. On the bottom-line, we expect non-GAAP earnings to be in the range of a loss of $1.25 million to income of $0.25 million, and non-GAAP EPS to be between a loss of 6 cents and income of 1 cent per share, based on a weighted-average diluted share count in the range of 21.0 million to 22.0 million shares.

For the full year, we expect endpoint IC volumes to be between 7.8 and 8.0 billion units, representing 32% growth over 2016 at the midpoint and a 2010 to 2017 volume CAGR of 36%, unchanged from the 2010 to 2016 period. We remain on-track to reach our target model in 2019 to 2020, with endpoint IC revenue greater than 60% of our total, connectivity greater than 30%, and approximately 5% from software. We also target gross margins to be in the range of 57% to 60% and adjusted EBITDA to be in the range of 12% to 16%. As a reminder, we expect to maintain EBITDA margins in the low single-digits in 2017 and anticipate some leverage in the model in 2018.

With that, I will turn the call over to the operator to open the question-and-answer session.