Impinj Fourth Quarter 2017 Earnings Conference Call
Thursday, February 15, 2018
5:00 p.m. ET / 2:00 p.m. PT

Chelsea Lish, Investor Relations for Impinj

Thank you, operator. Thank you all for joining us to discuss Impinj's fourth quarter 2017 results. On today's call, Chris Diorio, Impinj's co-founder and CEO, will provide a brief overview of our vision, market and performance. Evan Fein, Impinj's CFO, will follow with a detailed review of our fourth quarter 2017 financial results and first quarter 2018 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.

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. Please see the risk-factors sections in the annual and quarterly reports we file with the SEC for additional information about these risks. 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, except for 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 to the financial results, I'd like to announce that Chris and Eric will attend the Morgan Stanley Technology, Media and Telecommunications Conference on February 26th in San Francisco. We hope to see many of 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 Chelsea. Thank you all for joining the call. We have four items to cover today:

1. The market environment and our first-quarter 2018 expectations
2. Our long-term vision and our roadmap to deliver that vision
3. Our fourth-quarter 2017 results, and
4. Our 2018 financial outlook

I will focus on the first and second topics. Evan will cover the third and fourth. During my remarks I will refer to a graphic in the script, so if you haven't yet downloaded the script from the Impinj website I encourage you to do so now.

Starting with an overview of our results and guidance, fourth-quarter revenue was $26.9 million, below our preliminary estimates. Our first-quarter revenue outlook is between $23.25 and $25.25 million, above our prior estimates. Both numbers were affected by us accommodating a partner's request for a product exchange, as Evan will cover shortly. Systems sales exceeded expectations, with reader and gateway unit volumes up 42% year-over-year, our third consecutive quarter with greater than 40% unit-volume growth. For the most part we sidestepped reader and gateway supply constraints by operational execution and our customers requesting a different product mix than we expected at the beginning of the quarter. Our 2017 endpoint IC shipments were 7.1 billion units, in-line with our revised guidance.

Turning now to our target verticals, retail, logistics and healthcare, the primary driver of our 2018 endpoint IC volumes will be retail. But because retail will still use mostly handheld readers in 2018, meaningful retail systems revenue is farther out in time. By contrast, logistics and healthcare offer 2018 systems opportunities, but with small 2018 endpoint IC volumes because today's use cases mostly track pallets and assets, with consumables tagging farther out in time. Consequently, rather than provide annual endpoint IC guidance in 2018 as we have done in the past, we will instead provide quarterly revenue results for endpoint ICs and for systems, the latter comprising our platform's connectivity and software layers. We believe this segmentation better aligns with how we view our business and how we track the fixed-reading adoption wave I have discussed on prior calls.

Starting with endpoint ICs, our endpoint IC lead times have contracted from an average of 10 to 12 weeks in 2016 to an average of 4 to 6 weeks today. As a consequence, we have seen a significant reduction in our order backlog, and we expect our inlay partners to further reduce their inventory by between 500 million and a billion units, mostly in the first and second quarters. As a result, even though we anticipate 15% to 20% growth in end-user endpoint IC consumption in 2018, our first-half 2018 unit-volume growth will lag end-user consumption. Regarding pricing, we expect our 2018 competitive environment to remain unchanged from the second half of 2017. We also expect to at least maintain end-user market share on a full-year basis compared with 2017.

Turning now to systems, we are enthusiastic about our 2018 opportunities because we believe we can address compelling unsolved problems in logistics and healthcare. The end-user and partner engagements I have cited on prior calls, such as for Faurecia in logistics or with Stanley Healthcare, and many others like them, fuel our enthusiasm. Because our opportunities are project-based, size, timing and mix will play an important role in our results when viewed on a quarterly basis.

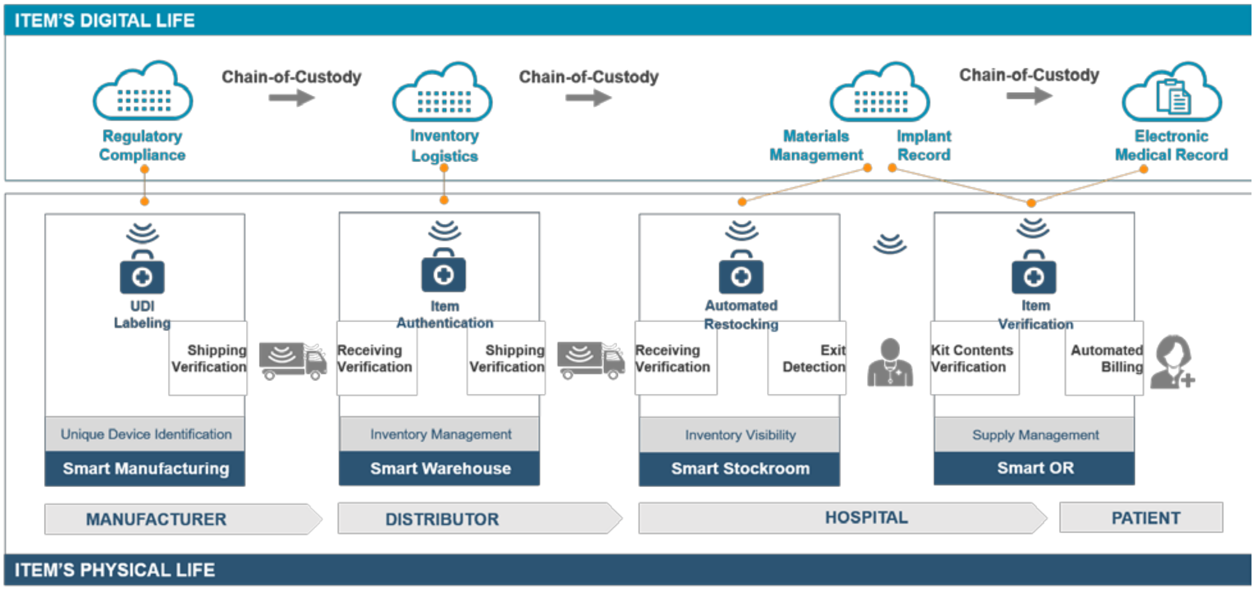
Let me now add a few clarifying comments: First, we remain confident in both our market opportunity and our market position. Second, we continue investing in our integrated platform, with a focus on retail's coming transition to fixed reading and logistics and healthcare adding consumables tagging, while at the same time supporting partners who are driving our platform's adoption in other verticals such as airlines, laundry and automotive.

Focusing for a moment on our platform, we link its three layers to deliver advanced capabilities and performance that surpasses mix-and-match solutions built from competitor products. Today, those linkages are primarily algorithms shared by our operating-system software, readers and gateways. Over the next three years we will extend those linkages substantially, with our next-generation reader delivering item-authentication features that our operating system will deliver as a cloud service, and our next-generation endpoint IC connecting via our platform to that cloud service.

We are driving a future where every item in our everyday world has a digital counterpart, a digital twin, in the cloud. The essence of our platform roadmap is to connect physical items with their digital twins. Today we deliver each physical item's identity, location and authenticity; our future is linking those physical items with cloud-based twins that include the item's history, ownership and available services. Our operating system will include some of those services, including those essential for developers to link business and people with items.

Step-by-step we are creating that platform to connect everyday items to their digital twins. To highlight our vision and our business opportunity in concrete terms, I'd like to walk you through a representative healthcare example that we believe will improve medical-device traceability, hospital reimbursement and, ultimately, patient care.

Consider a medical device such as a heart valve as it journeys from manufacturer to distributor to hospital to patient. The manufacturer uses our platform to associate our endpoint IC in the valve's packaging with the valve's digital twin in the cloud. Our platform tracks the valve from WIP through shipment to a distributor. The distributor uses our platform to read the IC, authenticate the valve, create a new digital twin, chain this new twin to the prior twin cryptographically and automate the



chain-of-custody transfer. A hospital that uses our platform for automated restocking autonomously orders the valve. Upon receipt, the hospital uses our platform to read the IC, authenticate the valve, create a new digital twin, chain this twin to the prior twin and automate chain-of-custody transfer. Prior to a surgical procedure the operating room (OR) autonomously orders the valve from stock, ensuring receipt and surgical-kit completeness. During surgery the OR automatically bills the valve's use and associates the valve's digital twin with patient's medical record. All without human intervention.

To enable and win opportunities like this healthcare example we are investing in revolutionary product developments and lighthouse accounts. Yes, our vision is audacious. Yet we intend our three-year platform roadmap to enable opportunities such as that healthcare example and others like it. And while we are disappointed in our recent short-term financial performance, our focus on our vision is unwavering and our dedication intense.

We recognize that RAIN is one of many item-to-cloud connectivity technologies. Yet we firmly believe that RAIN's capabilities – unique identifiers, no battery, low cost, long range, not-line-of-sight, 1000 reads per second, essentially unlimited life and cryptographic authentication – are unmatched by any other technology and enable RAIN to coexist with those other technologies yet dominate item-to-cloud connectivity. If you'd like to see that coexistence and RAIN's differentiated capabilities then consider attending the open day of the Connections Summit hosted by the RAIN Alliance, the NFC forum and Google in Sunnyvale on March 7th.

Before I turn over the call over to Evan to give you a detailed look at our fourth-quarter results and first-quarter outlook, I would like to take a moment to comment on his departure. I know I speak for the entire Impinj team when I express my gratitude for Evan's countless contributions over the past

17 years. We will miss the partnership we have forged. Evan will remain with the company through March 30th and we are actively searching for his successor. I'm confident we will add an outstanding CFO, and together we will win this gigantic market opportunity.

Evan.

Evan Fein, Impinj Chief Financial Officer

Thanks, Chris. Before I review our fourth quarter and year 2017 financial results I want to remind you that with the exception of revenue, or unless explicitly stated otherwise, today's statement of operations 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.

Fourth-quarter revenue was $26.9 million, compared with $33.7 million in the fourth quarter of 2016, below the preliminary estimates we announced in our February 1 prerelease. After that prerelease we agreed to a partner's request for a one-time product exchange, requiring us to take an accounting reserve and decrease our 2017 revenue by $3.2 million. There is also a decrease to our cost of sales and an increase to our inventory. We expect to reverse this reserve in the first quarter of 2018 when we complete the exchange and recognize $3.2 million in revenue at that time. We increased our first-quarter guidance by this $3.2 million reserve.

Fourth-quarter revenue mix was 65% from endpoint ICs and 35% from systems, the latter including readers ICs, readers, gateways and software. Endpoint IC revenue was down 33% while systems was up 27%, both compared with fourth-quarter 2016.

For the full year, we grew revenue 12% to $125.3 million. Endpoint ICs represented 73% of that revenue, up 6% from the prior year to $91.7 million. Systems represented 27% of that revenue, up 29% from the prior year to $33.6 million.

Fourth-quarter gross margin was 50.5%, compared with 53.7% in the prior quarter and 55.6% in fourth-quarter 2016. The sequential decline was due to the product exchange, ASP reductions, product mix and a temporary increase in production costs due to reduced volumes.

Total fourth-quarter operating expense was $19.3 million, or 72.0% of revenue, compared with $19.0 million, or 58.4% of revenue in the prior quarter. R&D expense was $7.7 million, or 28.5% of revenue. Sales and marketing expense was $7.9 million, or 29.5% of revenue. G&A expense was $3.7 million, or 13.9% of revenue. We ended the quarter with 311 employees, compared with 310 employees at the end of last quarter. Our adjusted EBITDA was a loss of $5.8 million, compared with an adjusted EBITDA loss of $1.5 million in the prior quarter.

GAAP net loss for the fourth quarter was $9.3 million, and for the year was $17.3 million. Non-GAAP net loss for the fourth quarter was $5.9 million, or 28¢ per share, using a weighted-average diluted share count of 20.9 million shares. Non-GAAP net loss for the full year was $6.1 million, or 29¢ per share, using a weighted-average diluted share count of 20.7 million shares.

Turning to the balance sheet, our cash position is strong and our business plan is fully funded. We ended the fourth quarter with cash, cash equivalents and short-term investments of $58.1 million, compared with $62.5 million in the prior quarter. Our accounts receivable balance is healthy at $22.2 million, down from the prior quarter. Because of the new U.S. statutory tax rate, we adjusted the value of our deferred tax assets, resulting in a one-time reduction of approximately $19.5 million in the fourth quarter. Our total end-of-2017 federal NOL was $126.4 million.

Inventory totaled $47.1 million, up $1.3 million over the prior quarter. We moderated fourth-quarter endpoint IC inventory growth by slowing production and reducing wafer starts, but because our production cycle times exceed 5 months and we desire adequate wafer supply in a year of global semiconductor wafer tightness, we anticipate a further inventory build in the first quarter. We will stage this additional inventory mostly in WIP rather than as finished goods and remain confident that it does not have material obsolescence risk. We will also continue investing in reader and gateway inventory to meet growing demand. We expect total inventory to grow by roughly $10 to $12 million in the first quarter, then decline sequentially through the remainder of 2018.

Turning now to our outlook, we expect first-quarter 2018 revenue in the range of $23.25 to $25.25 million. We expect adjusted EBITDA to be a net loss in the range of $7.5 to $6.0 million. On the bottom-line, we expect a non-GAAP loss of between $8.9 and $7.4 million, and non-GAAP loss per share between 42¢ and 35¢ per share based on a weighted-average diluted share count of 21.0 to 21.4 million shares.

I will add one final note on the first quarter. Although we attribute the majority of our revenue decline to inventory drawdown at our inlay partners, other factors include typical seasonality in our systems business, an ongoing reorganization of our APAC business and a short-term supply constraint for some reader ICs.

In light of our reduced revenue outlook, we have reduced expenses by eliminating some positions in our global work force, tightening our product-development focus, halting our office expansion and closing several remote offices. We expect these changes to save approximately $4.0 million in 2018 after one-time restructuring costs of approximately $4.0 million. Our cash position remains strong, allowing us to continue driving our long-term vision without sacrificing our ability to execute in this emerging market.

As Chris noted, we will no longer provide full-year endpoint IC volume guidance. Instead we will report revenue results for endpoint ICs and systems on a quarterly basis, with a historical breakdown on our website.

Before I open the call to questions, I'd like to take this opportunity to thank the entire Impinj team for their support, commitment and dedication during my 17 years with the company. We have together accomplished so much since I joined. I will now turn the call to the operator to open the question-and-answer session.