Impinj Third Quarter 2018 Earnings Conference Call
Monday, October 29, 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 third-quarter 2018 results. On today's call, Chris Diorio, Impinj's co-founder and CEO, will provide a brief overview of our market opportunity and performance. Eric Brodersen, Impinj's president, COO and principal financial officer, will follow with a detailed review of our third quarter 2018 financial results and fourth quarter 2018 outlook. We will then open the call for questions. Impinj's CFO Consultant, Linda Breard, and Impinj's Executive Vice President of Sales and Marketing, Jeff Dossett, are also on the call and will join Chris and Eric 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 financial numbers we discuss, 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 the company will attend ROTH's 4th Annual Corporate Access Day in New York on November 14th. 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.

Third-quarter revenue was a record $34.4 million, above the high end of our guidance and reflecting a return to growth on a year-over-year basis.

Endpoint IC sales increased sequentially, in-line with our expectations. We maintained steady supply and lead times while continuing to reduce our internal inventory. We also completed our channel inventory correction and expect to return to more-typical unit-volume growth rates going forward.

Our systems business had a record quarter, driven by strength in reader ICs and gateways. We shipped our 2 millionth connectivity device, another milestone towards our mission of connecting items in our everyday world. APAC systems revenue continued to increase as our new APAC team ramps productivity. We are energized by the opportunities for our systems business and remain focused on execution.

Turning to product introductions, we field-tested a significant ItemSense update, which we released in early October, that includes improved reader management capabilities, algorithmic enhancements for shipment verification and improved security for enterprise customers. With this latest version of ItemSense, our partners can leverage our entire platform including endpoint ICs, readers, gateways and algorithms to verify product shipments across the supply chain. This release, like all our product introductions, is focused on innovations that solve end-customer problems.

Turning to the market, I am encouraged by many use cases highlighting the strategic and economic benefits of RAIN-enabled item connectivity in the supply chain. Reynolds, a leading wholesale fresh-food provider, generated a positive ROI within 3 months using Impinj xSpan gateways and Monza-based tags to improve their supply chain. The Impinj gateways track reusable crates, each including a Monza-based tag, as they transition through dock doors, are loaded onto trucks, and back through the dock doors again when they return. Reynolds projects annual savings of more than $450,000. And a study from Auburn University on "Project Zipper," that used RAIN in retail supply chains to track item-level inventory from point of manufacturing, through a distribution center to a fulfilment center, highlighted a 3× improvement in order accuracy when comparing data from RAIN-based item scans to UPC data from barcode scans. These examples highlight the value that RAIN delivers at transition points throughout a supply chain. And in retail apparel, we continue to see new, world-class retailers adopting RAIN and existing retailers expanding their deployments. For the latter, we see retailers both expanding tagging to adjacent product categories like beauty, and expanding their deployments to additional uses cases like self-checkout and loss prevention.

In another positive move for the industry, the European Commission harmonized the availability of additional spectrum for RAIN operation in the EU, in a frequency range common to North America and most of Asia. In addition to simplifying system design, the added spectrum roughly doubles RAIN read speed and increases read range by 40% for readers that use the new spectrum. Impinj supported the efforts of multiple industry bodies and end-user companies in effecting this change.

As the RAIN technology leader, we continue advancing the depth and breadth of our patent portfolio as we innovate new technologies, products and solutions that our competitors try to mimic. We ended the quarter with 246 issued and allowed patents as we focus on extending our technology lead across our entire product line.

In summary, the Impinj team delivered another quarter in which we outperformed our guidance on revenue, EPS and adjusted EBITDA. Even as we head into the seasonally slower fourth quarter, we feel strong momentum as we pursue our vision of identifying, locating and authenticating trillions of everyday items and forecast another quarter of year-over-year revenue growth.

In closing, I would like to thank each and every Impinj employee for their focus, execution and dedication this quarter. I would like to extend a special thanks to our CFO Consultant, Linda Breard, as she continues providing strong and steady financial support and guidance.

I will now turn the call over to Eric for our detailed financial review and fourth-quarter outlook. Eric.

Eric Brodersen, Impinj President, Chief Operating Officer and Principal Financial Officer

Thank you, Chris. Except for revenue, or unless we explicitly state 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.

Third-quarter 2018 revenue was $34.4 million, compared with $28.5 million in the prior quarter and our highest quarterly revenue on record. Revenue mix was 69% endpoint ICs and 31% systems, compared with 70% and 30%, respectively, in the prior quarter. As a reminder, the latter includes readers ICs, modules, readers, gateways and software. Endpoint IC revenue increased 18% and systems increased 26% compared with the prior quarter. One element of our solid systems growth was our reader IC sales, benefitting from improved supply which was constrained in the first half of the year and is now caught up.

Third-quarter gross margin was 50.0%, consistent with the prior quarter. We took an excess and obsolescence charge related to the EU spectrum expansion, which may slow demand for EU systems products that remain saleable but don't leverage the additional spectrum. We continually evaluate our inventory relative to market conditions such as this spectrum expansion. Our current inventory comprises approximately 25% systems and 75% endpoint ICs, with the affected EU systems a subset of the 25%. Endpoint ICs operate over a very broad frequency range so our endpoint IC inventory is unaffected by the spectrum expansion.

Total third-quarter operating expense was $18.1 million, compared with $18.3 million in the prior quarter. We incurred approximately $1.4 million in expenses for the Audit Committee investigation, which is now concluded. That amount, which represents most of the investigation cost, is excluded from our non-GAAP operating expense. Research and development expense was $7.4 million. Sales and marketing expense was $6.5 million. General and administrative expense was $4.2 million.

Adjusted EBITDA was a loss of $895,000, compared with a loss of $4.0 million in the prior quarter and better than our guidance of a loss of $3.4 to $2.4 million for the quarter.

GAAP net loss was $7.1 million, or 33¢ per share and non-GAAP net loss was $1.1 million, or 5¢ per share, using a weighted-average diluted share count of 21.4 million shares.

On the balance sheet, we ended the third quarter with cash, cash equivalents and short-term investments of $54.7 million, compared to $52.8 million in the prior quarter. Net cash used in operations was $393,000 compared to $4.8 million in the prior quarter, primarily due to a $4.1 million sequential inventory decline. Our accounts receivable balance was $19.6 million, slightly down from $20.0 million in the prior quarter. Inventory totaled $49.2 million, down $4.1 million from the prior quarter. We continue to expect overall inventory to decline through the remainder of 2018.

Before I transition to fourth quarter guidance, I would like to remind you of the seasonality trends we typically see in our business. In the fourth quarter, lower endpoint IC volumes are partially offset by stronger systems sales. In the first quarter, annual endpoint IC pricing negotiations typically impact both revenue and gross margin while systems sales are seasonally lower. Although these are typical trends, any number of factors can mask that seasonality in any given year.

Turning to the fourth quarter, we expect revenue to be between $31 and $33 million, impacted by endpoint IC seasonality and reader IC supply fulfilling backlog in the third quarter. We are also incorporating the recent, macro industry trends and guiding prudently. We expect adjusted EBITDA to be a net loss of between $3.5 to $2.0 million. On the bottom-line, we expect a non-GAAP loss of between $3.8 and $2.3 million, and a non-GAAP loss of between 17¢ and 10¢ per share based on a weighted-average diluted share count of 21.45 to 21.55 million shares.

I will now turn the call to the operator to open the question-and-answer session.