Seeking Alpha

Transcripts

Netlist's (NLST) CEO Chuck Hong on Q4 2015 Results - Earnings Call Transcript

Feb 29, 2016, 9:58 PM ET | **Netlist, Inc. (NLST) Stock**

SA Transcripts
160.27K Followers

Follow us on Google for the latest stock news

Welcome to **Seeking Alpha!**

Articles on **NLST** are available to you for free for the next **30** days.

To continue receiving professional-grade analyses on **NLST** and gain access to similar insights across the entire market, subscribe to Premium before your trial expires.

Join Premium

Q4: 2016-02-29 Earnings Summary

EPS of -$0.05 misses by $0.02 | Revenue of $2.85M (13.35% Y/Y) misses by $348.00K

Netlist, Inc. (NLST) Q4 2015 Results Earnings Conference Call February 29, 2016 5:00 PM ET

Executives

Mike Smargiassi - Brainerd Communicators, Inc.
Chuck Hong - Chief Executive Officer
Gail Sasaki - Chief Financial Officer
Brian Peterson - SVP of Sales and Marketing

Netlist EX2076
Samsung v. Netlist
PGR2025-00071

Analysts

Richard Shannon - Craig-Hallum

Operator

Good afternoon. And welcome to the Netlist Fourth Quarter and Full Year 2015 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. Please note, this event is being recorded.

I would now like to turn the conference over to Mike Smargiassi. Please go ahead.

Mike Smargiassi

Thank you, Garry and good afternoon everyone. Welcome to Netlist's fourth quarter 2015 conference call. Leading today's call will be Chuck Hong, Chief Executive Officer of Netlist and Gail Sasaki, Chief Financial Officer. Joining Chuck and Gail today is Brian Peterson, SVP of Sales and Marketing. As a reminder, our earnings release and a replay of today's call can be accessed on the Investor Relations' section of the Netlist website at www.netlist.com.

Before we start the call, I would note that today's presentation of Netlist's results and the answers to questions may include forward-looking statements, which are based on current expectations. The actual results could differ materially from those projected in the forward-looking statements, because of the number of risks and uncertainties that are expressed in the call, annual and current SEC filings and the cautionary statements contained in the press release today. We assume no obligation to update forward-looking statements.

During this call non-GAAP financial measures will be discussed. Reconciliations for those directly comparable GAAP financial measures are included in the press release, which was filed on Form 8-K.

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

Chuck Hong

Thanks, Mike and good afternoon everyone. Since our last call in November, we've made significant progress in the execution of our three pronged strategy, this includes the introduction of new product, our landmark agreement with Samsung and legal wins on the IP front. Each of these events has strengthened our ability to ramp revenues, bring new technologies to market and our additional strategic relationships and capitalize on our IP portfolio in the upcoming year ahead.

I would like to kick off today's call with a recap of the strategic partnership we announced with Samsung. This is a five year collaboration to jointly develop and bring to market a new class of Storage Class Memory or SCM products.

Based on Netlist HyperVault technology, the companies will work to commercialize what the industry has designated as NVDIMM-P category of SCM products. HyperVault is industry's first unified memory-storage architecture, by this we mean DRAM and Flash seamlessly tied together and working as one, so that to the computer system there is no distinction and memory and storage can be accessed as one space.

Effectively, we're blending high capacity, low cost NAND storage with a speed of DRAM and bringing it to the memory channel to achieve levels of cost performance that is vastly superior to any memory or storage technology currently available. That is the promise of Storage Class Memory. And it is the goal of Samsung and Netlist to be the first to bring SCM to the marketplace in a cost effective manner, and provide unprecedented benefits to our customers.

With the explosion of data, big data applications are increasingly straining under intense processing burden using existing technologies. Current analytics, work loads and future applications of cognitive computing, as well as Internet of Things all require huge amounts of in-memory computing and despite oversupply and decline of pricing in the commodity DRAM market, the cost of high capacity DRAMs that are required for big data remain prohibitively high for mass adoption of big data computing.

New technologies and architectures are needed to keep ahead of these demands and the industry has responded with introduction of new raw materials, such as phase change memory and resistive RAM that have been in development for many decades. They have the properties of both DRAMs and Flash, mainly speed combined with non-volatility and low cost capacity.

Unfortunately the reality is that those raw material based technologies require multi-billion dollar investments, creation of new ecosystems and standards that take years to achieve - and take years to achieve high volume yields.

By contrast HyperVault require – does not require architecture adoption or bias modification and plugs into existing server DIMM sockets and most importantly leverages DRAM and NAND proven materials that have been around for 30 to 40 years.

Among the technology candidates that have been announced to date, HyperVault is by far the most pragmatic and cost effective approach to Storage Class Memory. The partnership with Samsung is a recognition of the critical IP Netlist possesses for that and that our IP is at the core of next generation Storage Class Memory.

I am pleased to report that the joint development work for Samsung is off to good start. Our project teams had their kick off meetings in December and we're making good progress and on track to select samples, select customers within this year.

If we're successful in bringing this first generation of HyperVault to market in a timely manner, we expect that there would be a second phase to this engagement with Samsung as the agreement includes to right of first refusal to the technology.

As it stands, the $23 million in investment - sorry, as it stands the capital investment of $25 million associated with the deal that’s packed for Samsung to become a significant holder in Netlist, even more important, we believe this agreement will serve as a springboard for additional transaction in the future, discussions we're already having other players in the industry.

In 2015, we also saw a great success with our IP being validated by the Federal Court in the patent office even after strongly contested proceedings. In our landmark victory for Netlist the Federal Circuit recently upheld the validity of our 537 Patent, which covers load reduction, one of the fundamental features, aspects of LRDIMM [ph] from RDIMM.

In its most recent decision denying rehearing the Federal Circuit for all practical purposes ended Inphi's challenge to the 537. This re-exam lasted more then 4 years and generated numerous decisions from the PTO, the PTAB and the Federal Appeals Court. Inphi's only recourse at this point is an appeal to the Supreme Court which is unlikely to hear this case.

Late last year, we prevailed against SanDisk in the IPRs of two Netlist patents related to self test technologies that are lively used in LRDIMM and other products as well. These victories came on the heals PTAB rejecting multiple ways of IPRs filed by SanDisk and Smart Modular against three other Netlist patents, including the 185 patent covering the distributed buffer architecture invented by Netlist and adopted by the industry at DDR4 LRDIMM

There is a reason for all of these challenges from competitors, taken as a whole, Netlist LRDIMM portfolio covers the fundamental innovations at the heart of the LRDIMM. Without load reduction and distributed buffer architecture, LRDIMMs can not achieve the fastest speeds required high performance servers at DDR4, nor can the product function as an LRDIMM.

Over the next few years the speeds require by these servers will exceed the physical capabilities of the RDIMM or the Registered DIMM, leaving LRDIMM as the only viable server DIMM technology. The industry would not have been able to achieve these high levels of performance without the ground breaking work done by Netlist at DDR3 with HyperCloud.

Our innovations are being recognized and validated by the PTO and the Federal Courts and as a result, Netlist now has the only LRDIMM portfolio in the industry with patents that are survived reexamination and IPR reviews.

We've also made great strides last year with our Hybrid Memory Patent portfolio. Netlist invented the NVDIMM and has shipped more NVs today than all of our competitors combined. As with LRDIMM, Netlist is positioned as the creator of NV reflected - is reflected in the strength of our patent portfolio.

For example, two of the patents mentioned earlier where we prevailed against challenges from SanDisk and a Smart Modular cover the fundamental elements of the NV architecture. We've also had new patents issue covering the use of load isolation and hybrid memory designs as well as other key features of NV.

These successes have put us in a very strong position to pursue licensing opportunities in the fast growing LRDIMM market, which exceeded $3 billion in revenues in last year, as well as in the emerging NV or hybrid memory markets. It is our goal to execute one or more major licensing agreement this year.

I would now like call – now turn the call over to Brian Peterson, Netlist's Senior Vice President of Sales and Marketing, who will provide an update on our products business. Brian is an industry veteran who joined Netlist late last year. He bring significant knowledge of storage and cloud computing market places from his 20 years of experience in managing sales and marketing, operations and business development across global organizations. Most recently he served as Vice President of Sales and Business Development at Emulex Corporation, where he focused on cloud, data storage and emerging business for the company. Brian, welcome.

Brian Peterson

Thank you, Chuck. Really exciting time at Netlist, I am pleased to be here for several reasons. First, we have innovative technology, allowing us to bring unique product solutions to market. With my background in the storage and networking marketplace, I've seen first time the need for these solutions, a need not being adequately addressed by other offerings.

Second, Netlist is proven to be innovative and why is to protect this innovation through substantial IP portfolio. Third is the recent Samsung development and joint development agreement. Chuck highlighted some of the key elements of the strategic relationship with Samsung, as we are working with them on HyperVault product, but this partnership also enable us with Samsung technology products and customers not previously accessible.

While I've been here just a couple of months, we've made good progress of both the previously introduced EV3 product and the launch of our NV4 NVDIMM products. These products provides performance levels that are orders of magnitude to peers and was in the marketplace today from a top performance perspective and we remain confident they will continue to progress their early test or validation and customer deployments.

In January, at SNIA NVM Summit we introduced the DVR4 version of MDVault or MD4 and ran a demonstration that showcase our breakthrough performance with a five times increase in transactions per minute in a real world complex enterprise environment. Is that performance improvement which is critical to both enterprise organizations and cloud service providers who are spending large sums to run their infrastructure.

We delivered measurable performance improvements to translate to impactful cost ratings, which has quickly resonated with potential clients. We started our NV4 customer sampling in tandem with the recent product announcement to both OEMs and end customers for initial qualifications.

Today, the ecosystem is even more prepared for hybrid memory and we are helping accelerate it. We are working closely with system providers on the benefits they can provide to end customers by utilizing our NV4 NVDIMM in storage and server offerings.

Last weeks announcement about our collaboration with Supermicro is evident to that. Supermicro is been active in building the system readiness and we are working with them on customer application used cases. Based on this effort, we have several common customers in the early stages of testing.

We are also testing many of the end customers directly to discuss other application environments can achieve better results with our products and they can choose their preferred OEM, ODM or system provider to enable our technology.

The initial customer interaction is been very promising and other system providers are getting more active tied directly to end customer interest. We look forward to working with other partners and potential customers on our qualification process. We currently expect customers to start some of their deployments in the second half of this year.

In regards to our AV3 product, we're pleased to see progress with our previously sampled customers. We have several customers who are completing our first stage of testing and we'll be moving to their system level testing. We received POs for system level testing and expect to see more fillers [ph] for system level testing from several other customers in March.

We're also in the midst of the second round of sampling tied to broader customer awareness about how AV3 can benefit the end customer to increase performance and as cost savings.

Our product deployment has taken longer than originally indicated. We see another group of customer's progresses during the so qualification and system testing later in 2016. A greater [ph] understanding of the qualification requirements are server and storage system testing and we'll utilize this in our customer engagement.

It takes longer to qualify these hybrid memory products, longer than other products in the system environment. But it is directly tied to the critical need to maintain overall system data integrity.

The upside to this however is the stickiness associated with these products and customers based on the investment required for the testing effort. This translates into long-term revenue on which we can depend once we have made the full test and integration commitment. We have several customers entering full system test now and anticipate this associated revenue will start ramping in the middle of the year.

We made good progress with existing customer and customer engagement, but I have been working hard with the team to expand the focus based on long standing customer relationships in the industry. I am encouraged by the positive customer feedback about how our product can be used to improve performance and cost savings as a result. I look forward to further progress with these engagements through the steps that [indiscernible] lasting development relationships and long-term revenue.

Now let me turn the call over to Gail for the financial review.

Gail Sasaki

Thanks, Brian. The Samsung transaction that was closed at the end of the quarter provided inertia for our multi faceted improvement in our financial position. In addition to providing a platform to enhance value in many areas as Chuck and Brian have already discussed, let me begin with a quick summary of the financial terms of Samsung's recent infusion of $23 million of capital into the company.

The first component is just $2 million of long-term convertible debt with essentially equity like terms with no payments of principal or interest due over the course of the six year term, and at below market interest rate of 2%.

The debt has automatically converted to common stock at a conversion price of $1.25 which was a premium of 89% over the closing price of the stock on the day we closed the transaction.

Samsung cash to covert to debt to equity until maturity. However, Netlist has discretion to repay the debt prior to maturity or to allow the debt to convert to equity at term. The agreement with Samsung contains no restrictions, financials or operating covenants, nor any anti-dilution protection for Samsung.

The second component consist of 8 million in NRE which includes an agreement to work together with a Samsung memory business unit in Korea, jointly developed as standardized product interface for NVDIMM-P memory modules.

During the three month since the close of the transaction we have made better than expected progress on the joint development and have recognized $1.1 million of the NRE during Q4 and are on track to recognize the remaining revenue during the first half of the year.

Simultaneous to the close of the Samsung transaction, we also repaid a short term high interest debt owe to Fortress and eliminated the overhang on our patent portfolio of $8 million of future patent monetization liability also owe to Fortress. And we restructured $2 million in short term liabilities to vendors.

Finally, we also recently renewed our working capital line of credit with Silicon Valley Bank. Our new agreement has more favorable churns, a better interest rate, along with elimination and relaxation of financial covenants.

The line continues to have a total capacity of $5 million limited by 80% of our accounts receivable balance. As a result of these collective actions, we have a significantly stronger balance sheet of $5 million working capital line from Silicon Valley Bank and a financial and strategic back into Samsung, which taken together will provide sufficient run rate to support the priorities in front of us.

Now for a brief recap of the last quarters numbers. Revenues for the fourth quarter ended January 2, 2016 were $2.9 million compared to revenues of $2.5 million for the fourth quarter ended December 27, 2014.

Total revenue in the most current quarter includes $1.1 million in NRE from our strategic agreement with Samsung. The NRE will be recognized as we execute on product development work under the partnership and as I said earlier is on pace to be fully earned by the end of June, 2016.

Revenues from the sale of our products was flattish compared to the third quarter of 2015. Gross profit for the fourth quarter ended January 2, 2016 was $1.3 million compared to a gross profit loss of 113,000 for the fourth quarter 2014. This positive increase of $1.4 million reflects the profits earned from the Samsung NRE in addition to lower factory cost and better inventory management during the most recent quarter.

Net loss for the fourth quarter was $4.3 million or $0.09 loss per share, compared to a net loss in the prior year period of $5.8 million or $0.14 loss per share. These results include stock-based compensation expense of 500,000 for the fourth quarter of 2015 and for the fourth quarter of 2014 and non-recurring other expense of $1.7 million during the most current quarter.

Adjusted EBITDA loss after adding back net interest expense, income taxes, depreciation, stock-based compensation and net non-operating expense was a loss of $1.4 million for the 2015 fourth quarter, compared to an adjusted EBITDA loss of $4.8 million for the prior year period.

Operating expenses were $3.2 million in the fourth quarter compared to $5.3 million in last year’s fourth quarter. After subtracting intellectual property and legal fees from both periods, operating expenses were higher in comparison to last year’s fourth quarter, primarily due to legal cost of the recent transaction, headcount increases and other related headcount cost.

We ended the quarter with cash and cash equivalents and restricted cash of $20.1 million, as compared to $13.4 million at the end of the third quarter. We will remain disciplined in managing our expenses, while continuing to invest in 2016 fiscal growth.

I would also like to update you on our NASDAQ listing. We are pleased to have regained 4 compliance with both the bid price and market value listing requirements as of February 10, 2016. We highly value our NASDAQ listing and committed to maintaining that listing as an important component of our plans to drive future shareholder value.

Finally, just to note that we will be attending two industry conferences in March, Chuck will be participating in a panel discussion on the future of storage class memory at Susquehanna Financial Group 5th Annual Semi, Storage & Technology Conference in New York City on March 10 and he will also be presenting at ROTH 28th Annual Investor Conference in California on March 14.

I'll now turn the call back over to Chuck for concluding remarks.

Chuck Hong

Thanks, Gail. There is no doubt that the market is transitioned to hybrid and storage cost memory as a significant opportunity for Netlist and that we have IP that covers the fundamental technology at the core of the shift. The Samsung agreement is a validation of this.

We entered 2016 with momentum across our business as we kicked of our collaboration with Samsung, introduced NV4 and prevailed against Inphi in the landmark LRDIMM patent case. We are very excited about the opportunities we see in front of us. Thank you all very much for listening and we are now ready for questions.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Richard Shannon with Craig-Hallum. Please go ahead.

Richard Shannon

Great. Thanks for taking my questions, Chuck, Gail and Brian. Congratulations on a good finish to the year and on the Samsung deal, it's great to see. I guess my first couple of questions, maybe I'll start on the product side. Brian you gave us good preview of your – of what you've been working on primarily, let me ask individually on each of those kind of major plans here.

So on EV3, we've heard about for the last couple of quarters, it sounds like there is lot of interest and you talked about and you got over couple dozen customers here, what's the – what's kind of the timeframe you expect to see some real product revenue here – revenues here, it sounds like you get some early or kind of late testing stage revenues here in the first quarter, first half, and kind of what you see as a tan as we look into next year?

Brian Peterson

Yes. Good question, Richard. Obviously we've been talking about AV3 for a while because the samples have been - starting out towards the end of the year – third quarter and the timeframe before I joined.

What we're looking at is, at this point obviously you cast a wide net early on and then you drilled down into that into where you can get the customers progressing. As I've indicated in my remarks, the testing cycle because these are storage products and they do require persistent on it, it does take longer than normal than a memory product or even other components that are in the system.

So these qualifications once they have done the initial testing and they've proven that the product works as it does and as we've indicated that they can go and utilize this, they will move into full system testing. That can take somewhere in the neighborhood of 8 to 16 weeks, depending on the customers and then go on plan for deployments.

So as I indicated previously, that we'll start seeing the revenue ramping in the middle of the year and we'll start to see - enjoy some of that revenue from these customers that have progressed towards the end of the year.

Richard Shannon

Okay. And how do you see the profile of the customers that are ramping here, are there more storage or more server, and what's the interest level as you look at kind of Tier 1 versus maybe smaller customers?

Brian Peterson

The ones who have progressed is - we have a mix actually, which is nice. And we have some that who are utilizing this – who would be considered traditional storage customers, but others who are looking at this and data center applications as well. So the mix in the customer that we are engaged with it is across the board and there are a variety of used cases for how this product can get utilized.

Richard Shannon

Okay. Fair enough. Maybe just a quick question on NV and HV here, it sounds like you're also making some good progress there, maybe this has kind of similar timeframe there, I guess, I'll take it from your prepared comments Brian you are looking for some sort of acceleration as we get towards the end of the calendar year, is that fair take on what you said?

Brian Peterson

Yes, it is.

Richard Shannon

Okay. How do you the customer base there compare or contrast with EV3, I would imagine it’s a bit different. But how do you envision that one [indiscernible] it’s kind of levered what you do with EV3 to help with NV and the HV product?

Brian Peterson

Yes, definitely that’s – there is some overlap with these customers, that you would guess that the traditional ones who would be people who are building up storage type appliances or server solutions that are also utilizing storage capabilities. So there is some overlap to an extent and in the case of EV3 versus an NV4 product there is opportunity to broaden vault [ph] to the used cases and that there is some more capacity that can be leveraged there, and for an EV3 it’s a little bit limited to what you can put on PCI card versus something where you can put deployments broader in the memory channel.

Richard Shannon

Okay. Got it. Fair enough. That's helpful. Maybe jumping over to the licensing side, obviously the Samsung deal announced late last year is very interesting here, wondering and I don't know either Brian or maybe its more Chuck, as you can kind of talk through about the progress that are in other kind of interim [ph] test to their hard disk drive and you don't want to limit your negotiating position there, as that's moving on.

But is there any reason to suggest that we're not going to see some sort of unit base royalty type of agreement either with Samsung or anyone else that might have some interest out there in the industry?

Chuck Hong

With Samsung Richard, you know that the agreement is a joint development agreement for commercializing HyperVault from where its out today to trying to get into a production worthy product and getting in customers and we're working together to do that very closely.

That is so – and we're making a good progress there and as we said the roles to get the samples out to select customers during the year. So that is more of a development agreement. We believe once the product is commercialized that there will be opportunity for a second phase engagement with Samsung, that is there is right of first refusal on the acquisition of the technology in this agreement.

So once the product goes to market we will probably have a separate agreement talking about the economics to supply agreement, marketing agreement and so forth. As to the patent licensing, that is a separate discussion that we're having with multiple parties today outside of Samsung.

Richard Shannon

Okay. To follow up on this topic, I mean, [indiscernible] Chuck it was in your prepared remarks, something that Brian mentioned that, it is sort of your goal to have a license agreement, at least one license agreement signed this year, is that that basically referring to kind of Samsung and or one of the other large DRAM and NAND makers or is this more general to the overall patent portfolio more broadly speaking, just want to make sure I understand the context of the comment?

Chuck Hong

It is referring to someone outside of - other than Samsung.

Richard Shannon

Got it. Okay. Okay, great. I guess, maybe couple more questions, I will jump in last because others coming on the call here. But if I am to think about how we should be looking at your financial - your income statement for the first quarter, I guess, from what I've heard you, it sounds like your product revenue should be hopefully flat to maybe even up [indiscernible] over EV3 revenues.

How should we think about the licensing revenue recognized from your deferred revenues coming from the Samsung deal and how does that come into an overall thought process of what fiscal revenues can be?

Gail Sasaki

I'll take part of that, on the NRE from Samsung, as I noted we are definitely making better than expected progress, and we should be recognizing the remaining balance before the end of the second quarter.

Hopefully somewhat evenly over the course of that time, but it is somewhat milestone based. So we'll be reporting more on next quarter and as for the product piece.

Brian Peterson

Yes, as the product piece is as I've indicated, Richard, that’s based on the length of their cycles and where some of these customers are progressing. We will see some revenue for both EV3 and NV4, but these are sample POs that – they are putting in and talking about tens and hundreds of units that they would go to do their full system testing.

So that’s great news. Obviously they are showing commitment and paying for this and it shows for us good confidence that they are moving forward, but it isn’t sizeable revenue. So in general compared to where we have been its more inline with recent quarters.

Richard Shannon

Okay. I agree. Fair enough. This is my last quick question. I'll jump of the line for you guys. Gail, what are you forecasting for your exiting the cash balance here assuming now they are outside licensing or whatever situation, how should we think about cash flow down, similar to dollar amounts from the third quarter or how should we think about that and to discussing on an operating cash flow basis?

Gail Sasaki

Right. So yes, as I noted, we do have much improved balance sheet and as we look forward I think we should remain in about $3 million - $3 million to $4 million operating cash burn range, also noting that the retirement of the purchase loan makes us debt free with no cash debt service payments and the Samsung loan is our only outstanding debt with no payment probably end of the term.

Richard Shannon

Great. Okay. Thanks for the reminder and I think that is all of my questions. I will jump of the line guys. Thank you very much and congratulations.

Gail Sasaki

Thanks, Richard.

Chuck Hong

Thanks, Richard.

Operator

This concludes our question-and-answer session. And the conference is also now concluded. Thank you for attending today's presentation. You may now disconnect.

- Read more current NLST analysis and news
- View all earnings call transcripts

Comments

Sort by Newest

If you type a company or ETF ticker symbol in capital letters we will automatically link to the symbol page. You can remove the link by deleting the $ in the comment.