Seeking Alpha

Transcripts

# Netlist's (NLST) CEO Chuck Hong on Q2 2017 Results - Earnings Call Transcript

Aug 10, 2017, 9:05 PM ET | **Netlist, Inc. (NLST) Stock**

**SA Transcripts**
160.48K 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 **20** 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

## Q2: 2017-08-10 Earnings Summary

EPS of -$0.06 misses by $0.01 | Revenue of $11.40M (64.61% Y/Y) beats by $1.14M

Netlist, Inc. (NLST) Q2 2017 Earnings Conference Call August 10, 2017 5:00 PM ET

### Executives

Mike Smargiassi - Investor Relations
Chuck Hong - Chief Executive Officer
Gail Sasaki - Chief Financial Officer

### Analysts

Netlist EX2092
Samsung v. Netlist
PGR2025-00071

Gary Mobley - The Benchmark Company

**Operator**

Good afternoon and welcome to the Netlist Second Quarter 2017 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] 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, Anita, and good afternoon, everyone. Welcome to Netlist's second quarter 2017 conference call. Leading today's call will be Chuck Hong, Chief Executive Officer of Netlist; and Gail Sasaki, Chief Financial Officer. As a reminder, our earnings release and a replay of today's call can be accessed on the Investors section of the Netlist website at 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. We had another productive quarter, as the Netlist team remains focused on the execution of our strategic initiatives, including the growth of base products, the commercialization of HybriDIMM, and the licensing of our intellectual property.

We continue to deliver strong revenue growth with our top line up to 65% from the prior year period, driven by sales of Samsung's high-end memory and storage products. We're seeing synergistic benefits from the strategic relationship with Samsung that we believe surpass its core focus to assist with the commercialization of HybriDIMM, our storage class memory product.

The ability to resell Samsung high-performance memory and storage solutions to end customers that are not reached and Samsung's distribution model allows us to establish direct relationships with key datacenter customers, the same customers we are targeting for hybrid memory products and storage memory – storage class memory. We also seek to engage with customers interested in using our NVDIMM products, as a faster tier of access to data remains very active.

During the quarter, we were asked to participate in bids from global OEMs and are also fulfilling ongoing orders from Inspur. We look forward to results of the bids and our qualification work to ultimately moving forward towards production and revenue.

At the Flash Memory Summit this week, we announced Netlist's HybriDIMM product concurrently operated a Big Data and in-memory database application in multiple access modes. MongoDB exercises HybriDIMM's in-memory channel block storage capabilities, while the Redis In-Memory Database utilizes memory semantics to achieve a true persistent memory solution.

This was accomplished while not impacting memory channel bandwidth and we believe it's an industry-first and a significant breakthrough for HybriDIMM. The CPU ran all data from the memory channel with nothing sitting in the storage channel, no hard drive, no SSD. And by so doing, eliminating the need for the CPU to fetch data out of storage.

HybriDIMM essentially frees up the CPU from this task and deliver significant improvements in speed. As we witnessed at SMS, there is excitement around storage class memory and in the cost performance benefits that HybriDIMM can deliver. The industry is experiencing a super cycle with heavy drivers of server DRAM demand, such as datacenter growth, artificial intelligence, autonomous driving and the Internet of Things coexisting with difficulties and DRAM migration to higher densities and performance.

It is with this backdrop of expanse of server memory growth that we continue to work with Samsung on HybriDIMM under our joint development agreement. We remain on track with the commercialization effort and has partners and potential customers globally who have requested early samples.

Moving on to our intellectual property efforts. In late July, the U.S. Court of Appeals for the Federal Circuit vacated and remanded an earlier decision by the U.S. Patent Trials and Appeals Board, which had invalidated certain claims of two Netlist patents covering fundamental load reduction technology used in various server memory products, such as LRDIMMs.

In its ruling, the Federal Circuit found that the PTAB's earlier decision were based on an erroneous interpretation of the patent claims. As background, we asserted these patents against SanDisk and Diablo Technologies ULLtraDIMM product as part of a seven-patent lawsuit in the U.S. District Court for the Northern District of California. SanDisk and Diablo had filed multiple IPRs against all seven asserted patents.

We prevailed in the final written decisions in five of the seven patents. The final two of the seven will now go back to the PTAB to reconsider validity and view of the Appeals Court win. Netlist has had an exceptional track record in defending its intellectual property and validity challenges before the PTAB, and we look forward to next steps.

Netlist's litigation adversaries have filed a total of 29 IPR petitions since 2014. The PTAB found in ten of these petitions that the threshold showing of – invalidity was not met and denied institution altogether. Netlist prevailed in four other reviews that preceded to a final written decision. The remaining reviews are either in process or on appeal.

Netlist has not yet lost a single fully adjudicated review, which we believe reflects the seminal nature of the technical innovation of our engineers developed over a decade. As part of our broader efforts to defend Netlist's intellectual property worldwide, we recently filed lawsuits against SK hynix in Germany and China, which we believe highlights the strength of Netlist patent portfolio and jurisdictions globally.

These actions are based on SK hynix alleged infringement of Netlist patent at distribution buffer architecture, which was adopted as the industry standard for DDR4 LRDIMM. The German lawsuit targets the sale of SK hynix LRDIMM either alone or installed in enterprise servers, the lawsuit filed in China targets the sale of SK hynix LRDIMM to enterprise customers in that country, as well as the sale of same products to server manufacturers that integrate SK hynix LRDIMM into servers for worldwide export. We expect that both cases will go to trial at some point next year.

Regarding the ongoing investigation at the U.S. International Trade Commission in Washington D.C., administrative law judge Essex conducted a week long intensive trial earlier this year in May. This represents a significant step in our overall effort to address SK hynix's pervasive and unauthorized use of Netlist's IP.

We look forward to receiving ALJ Essex's detailed findings of fact and conclusions of law and a final initial determination this October. This decision will include a recommendation as to whether an exclusion order should issue that direct U.S. Customs to stop allegedly infringing SK hynix's LRDIMM and RDIMM products from entering the U.S.

We estimate the shipments to be highly valuable due to the high demand for high-performance memory within the U.S. and worldwide. Recent analyst estimates show the worldwide market for server memory increasing from $10 billion in 2016 to over $16 billion this year, of which a large portion is shipped into the U.S. and SK hynix accounts for a significant portion of this whole.

We remain open to negotiating a fair and reasonable license with SK hynix, but despite extensive and prolonged efforts over the past year-and-a-half to negotiate an equitable resolution. SK hynix has refused to fairly compensate Netlist for our intellectual property.

In cooperation with our legal and financial partners, we will continue to take the necessary actions to defend our intellectual property rights. We are determined to continue these efforts until we are able to reach a resolution with SK hynix that fairly compensate Netlist and our shareholders and our financial arrangement with TRGP provides the financial resources to see these efforts through to the end.

In summary, we remain focused on the execution of our strategic initiatives, including the growth of synergistic product revenue via Samsung resale products and Netlist's proprietary and industry-standard hybrid memory products, the commercialization of HybriDIMM and the licensing of our intellectual property.

We believe our strategic legal and financial partners, including Samsung and our patent portfolio that reflects groundbreaking work in the area of high-performance server and hybrid memory, will support our efforts to execute these strategic initiatives.

I'll now turn the call over to Gail for the financial review.

**Gail Sasaki**

Thanks, Chuck. We once again delivered substantial growth in our quarterly revenue performance, with double-digit increases in product revenues for the past four consecutive quarters.

Revenues for the second quarter ended July 1, 2017, were $11.4 million, compared to revenues of $6.9 million for the 2016 period, an increase of 65%. The year-over-year increase in revenue, primarily reflects the multiple benefits of our joint development agreement with Samsung and addition of their high-end memory products to our product offering.

On a consecutive quarterly basis, product revenue improved approximately 21%. In the third quarter, we do expect continued growth in our product revenue on a consecutive basis, but at a slightly softer rate than recent periods.

Second quarter 2017 gross profit was 644,000, compared to $3.7 million in the year-ago period, reflecting product mix and the inclusion of $3.4 million of non-recurring high-profit engineering revenues in the year-ago quarter, which we are in for work on Phase 1 of the Samsung joint development agreement.

Net loss for the second quarter was $3.8 million compared to a net loss in the prior year period of $1.5 million. The increased net loss in the period, primarily reflects again the inclusion of NRE revenues in the year-ago period.

Adjusted EBITDA loss after adding back net interest expense, income taxes, depreciation, amortization, stock-based compensation and net non-operating expense was a loss of $3.3 million in the second quarter 2017, compared to an adjusted EBITDA loss of $1 million for the prior-year period.

Operating expenses were $4.4 million in the second quarter, compared to $5 million in the last year's second quarter. Expenses declined on an absolute basis across R&D, legal and SG&A. We ended the quarter with cash and cash equivalents and restricted cash of $7.6 million, as compared to $10.9 million at the end of the first quarter.

Going forward, we will continue to carefully manage our overall cash cycle and expect cash needs to decrease due to ongoing decreases in operating expenses, continuing contribution of product revenue margin and post-management of the overall cash cycle.

During the second quarter, we realized the benefit of $1.8 million and reduced legal expenses from our financial arrangement with TRGP. Our working capital line of credit with Silicon Valley bank has a total capacity of $5 million, capped by 80% of our eligible accounts receivable balance and we continue to leverage this for working capital to support the large increases in our product business volume, again, due mainly to our special access to Samsung high-performance memory modules.

Thank you for listening. Operator, we are now ready for questions.

**Question-and-Answer Session**

**Operator**

Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Gary Mobley with Benchmark. Please go ahead.

**Gary Mobley**

Hi, Chuck. Hi, Gail.

**Chuck Hong**

Hi, Gary.

**Gail Sasaki**

Hi, Gary.

**Gary Mobley**

Chuck, since you're probably still in Santa Clara or just back from the Flash Memory Summit, I want to start with some questions about HybriDIMM. I'm presuming that you had some discussions there with Samsung regarding HybriDIMM and/or continuing development relationship with Samsung. What are the prospects for Phase 2 relationship with Samsung and/or their option to pickup HybriDIMM after some sort of evaluation, if any at all?

**Chuck Hong**

Yes. Gary, the – so there's a Phase 2 part of this agreement was fell off the business terms around the commercialization and the economics. There is going to be a technical due diligence of the technology. We've taken steps, initial meetings have occurred.

Over the next 30 to 45 days, we will be going over to Korea and visiting with the entire technical and management team of Samsung to dig deeper into the technical due diligence. And thereupon after that evaluation, we'll get into the business discussions about the terms of the Phase 2.

**Gary Mobley**

Gotcha, okay. And moving onto the legal front, if I'm not mistaken there was a Federal District Court case heard in July relating to SK hynix patent issue. How did that the trial go? And what's the next date relating to it? Do you recall it off the top of your head?

**Chuck Hong**

Well, the – so the high-level picture on the legal front is really the ITC case, which we are waiting on a ruling on October 10. I think, that's going to be an important decision. The District Court, the Central District of California District Court case for the – there are two cases there on five patents and then two new patents.

The first case involving the five patents has been stayed, pending the reexamination at the PTAB. Our record, as I indicated at the PTAB, is very, very strong. And we believe that we are going to prevail. But in the meantime, while those examinations of the patents are going on, the five patent case has been stayed. We filed another case at the Central District with two newly issued patents and that case is ongoing.

**Gary Mobley**

Okay.

**Chuck Hong**

But that will probably not get to trial until the middle of 2018.

**Gary Mobley**

Okay. And since you, for all intents and purposes, won the appeal relating to the validity of the 150 and the 536 patents, sort of optionality, does that give you with respect to what for the most part it has been a very long patent battle with Diablo and Western Digital?

**Chuck Hong**

Yes, I think that opens up a number of options and we are considering deliberating over the existing lawsuit with SanDisk and Diablo. It also provides additional options for the SK hynix litigation as well, because these two patents relate to the LRDIMM, LRDIMM patents. And they've gone to really the highest court in the world of patents, unless they want to appeal it to the Supreme Court, which is probably unlikely.

So these two LRDIMM patents have run the gauntlet and have come back from the Federal Circuit with a determination that there – they are valid patent. So from that standpoint, I think, it opens up – puts us in a strong position in relations to both the hynix and SanDisk and Diablo suits.

**Gary Mobley**

Okay. I appreciate the color and I will step aside and let others ask questions. Thanks.

**Chuck Hong**

All right, Gary.

**Operator**

[Operator Instructions] This concludes today's conference. 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.