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MRAM - Q3 2016 Everspin Technologies Inc Earnings Call

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PRESENTATION

Operator

Good afternoon and welcome to the Everspin Technologies third-quarter financial results conference call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Jordan Darrow of Darrow Associates. Please go ahead.

Jordan Darrow *- Darrow Associates - IR*

Thank you, Austin, and thanks to all of you for joining Everspin's first earnings conference call as a public company.

Before we begin the call, I want to remind you that this conference call contains forward-looking statements regarding future events including, but not limited to, our expectations for Everspin's future business; financial performance and goals; customer and industry adoption of MRAM technology, including our second- and third-generation solutions, as well as other future products and technologies; and successfully bringing to market manufacturing products in Everspin's design pipeline.

These forward-looking statements are based on estimates, judgments, current trends, and market conditions and involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements. I would encourage you to review our SEC filings, including Everspin's prospectus filed with the SEC on October 7, 2016, in which we discuss risk factors associated with investing in Everspin.

All forward-looking statements are made as of the date of this call and, except as required by law, we do not intend to update this information.

In today's call we will be referencing GAAP and adjusted EBITDA numbers. EBITDA is provided to enhance the investors' understanding of Everspin's operating performance as it primarily excludes certain non-cash charges for depreciation and amortization, stock-based compensation expense, and compensation expense related to divesting of common stock held by GLOBALFOUNDRIES, resulting from our joint development agreement.

The use of EBITDA is not meant to be a substitute for results presented in accordance with GAAP, but rather should be evaluated in conjunction with our GAAP results. This conference call will be available for audio replay in the investor relations section of the Everspin website at www.Everspin.com.

Joining me today are Everspin's CEO, Phill LoPresti, and CFO, Jeff Winzeler. I would now like to turn the call over to Phill.

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Thank you, Jordan. Good afternoon, everyone. With this being our first time together on an earnings conference call, I will use today's session to make a few opening remarks and then ask Jeff to discuss our Q3 results in detail and provide our Q4 guidance. After that, I will come back and share some additional comments on why Everspin's technology is disruptive and why we believe we are at an exciting point for our company and in the memory industry.

For those of you who might not have seen our financial results press release that was issued this afternoon and posted on our website, let me briefly summarize our Q3 GAAP results.

Revenue for the quarter was $7.2 million. Gross profit was $4.3 million, resulting in a gross margin of 60%. Our operating expenses in Q3 were $5.5 million. These factors translated into a net loss of $1.4 million, or $0.54 per share, based on a 2.7 million average shares outstanding during the quarter. Our adjusted EBITDA loss for the third quarter was $810,000.

Overall, we were pleased with our third-quarter performance. Let me quickly highlight several especially noteworthy events in the September quarter.

An exciting new relationship with GLOBALFOUNDRIES was announced at the GLOBALFOUNDRIES technology conference, whereby our most advanced ST-MRAM technology will be available as an embedded memory to GLOBALFOUNDRIES' customers. Shortly after sampling our industry's first 256 perpendicular spin torque MRAM in the September quarter, this product was incorporated by Aupera Technologies in the world's first M.2 storage module and demonstration of Microsemi's Flashtec SSD Controller working with our 256 megabit perpendicular pMTJ [PDR3] product at the Flash Memory Summit in August.

With the completion of our initial public offering last month, together with a strong ecosystem in place to support the adoption of our MRAM solutions supported by GLOBALFOUNDRIES' relationship, we now have the resources, including working capital, to execute on our growth plans and expand the total addressable markets for our products, specifically in the enterprise market.

The Everspin team is highly focused on executing our plan and excited about the opportunity we have with our new products. Our first-generation MRAM products continue to show good growth and we remain on track with our second- and third-generation MRAM products.

After Jeff discusses our Q3 financial results in detail, I will come back and share our vision for Everspin with you today. With that I will pass the call over to Jeff to provide the detailed financial overview of our third quarter and provide our Q4 guidance.

Jeff Winzeler - *Everspin Technologies, Inc. - CFO*

Thank you, Phill, and good afternoon, everyone. First, let's review our third-quarter 2016 income statement.

Revenue in the third quarter was $7.2 million. Please note that our press release today stated the amount as $7.1 million, but the number actually rounds up to $7.2 million.

Product sales represented 98% of total revenue, while licensing and royalty contributed to the balance of revenue. Our third-quarter revenue of $7.2 million was up $503,000, a 7.6% increase over our revenue in the second quarter of 2016.

Looking at product sales alone, our revenue increased by 6%, or $413,000, when compared product sales in the second quarter. This increase was driven by our Gen 1 MRAM sales, which were up $677,000, or 14%, from the second quarter, offset by our legacy products, which decreased by $297,000, or 19%, when compared to the prior quarter.

Our direct sales representatives are organized into three primary regions: North America, EMEA, and Asia-Pacific. We recognize revenue by geography based on the region in which our products are sold. Our revenues by geography were as follows: North America revenue was $2.1 million, or 29% of revenue; EMEA was $1.5 million, or 21% of revenue; and Asia-Pacific revenue was $3.6 million, or 50% of total revenues.

Our gross profit for the third quarter was $4.3 million, an increase of $803,000, or 23%, over the second quarter of 2016. The resulting gross margin for the third quarter was 60% versus 53% in the second quarter.

Our gross margin expansion in the third quarter was a result of product mix, better manufacturing yields on volume products, and cost reductions of our direct materials. Additionally, we had an increase of $90,000 in licensing and royalty revenues which have no associated cost of sales and, therefore, result in 100% gross margin.

Our third-quarter 2016 operating expenses were $5.5 million compared to $8.5 million in the second quarter of 2016, a decrease of $3 million. Our research and development spending decreased by $1.4 million in product qualification expenses when compared to the prior quarter. These reductions are a function of fewer test and development wafers, lower mask expenses, and less engineering consumable spending for product qualifications in both Gen 1 and Gen 3 technologies during the third quarter.

The reductions in spending are not, however, reflective of our ongoing run rate of spending for ongoing product qualifications. In addition to these reductions, we experienced a one-time reduction in stock comp expense associated with our GLOBALFOUNDRIES joint development agreement, or JDA. We realized a credit of $691,000, as opposed to expense of $922,000, in the second quarter of 2016, for a total reduction in quarterly expense of $1.6 million when compared to the prior quarter.

This change was driven by a mark-to-market revaluation of stock comp. Those expenses, which in the third quarter were actually a credit, are recognized through our research and development line in our P&L. This is a one-time adjustment and we do not anticipate additional credits for this line item in future quarters.

Interest, taxes, and other income were expensed in the third quarter 2016 were $263,000 compared to $381,000 in the prior quarter. Our adjusted EBITDA loss for the third quarter of 2016 was $810,000, compared to an adjusted EBITDA loss of $3.5 million in the second quarter of 2016. The large difference in the EBITDA loss was primarily related to the large change in R&D spending and in the non-cash stock comp expense associated with the GLOBALFOUNDRIES shares.

Our GAAP earnings per share for the third quarter of 2016 was a loss of $0.54, resulting from a net GAAP loss of $1.4 million and an outstanding average common share count of 2.6 million shares. The share count used for the EPS calculation was the outstanding common shares of the Company prior to the IPO and does not reflect the conversion of preferred shares or new shares from the IPO or concurrent private placement that happened immediately after quarter-end.

Turning to our balance sheet, our cash and cash equivalents were $2 million at the end of the third quarter 2016, compared to $2.3 million at the end of fiscal year 2015. Total assets increased -- at the end of the third quarter 2016 were $15.6 million, up $11 million from the same balance at the end of 2015. The increase in assets was a result of $3.1 million in deferred offering costs and pre-IPO spending.

Total liabilities were $31.5 million at the end of the third quarter 2016, an increase of $14.8 million from $16.7 million at the end of 2015. The majority of the increase in liabilities was a result of $8.5 million of convertible note financing, $1 million of additional debt from our [Aries] line of credit, and $2.9 million in accrued liabilities associated with the GLOBALFOUNDRIES JDA expenses. Capital spending for the third quarter was $596,000.

Looking ahead to the fourth quarter, we expect continued growth in our Gen 1 MRAM business and reductions in the sales of our legacy products. We believe our revenue will range between $7.3 million and $7.6 million for the fourth quarter of 2016. We expect our resulting GAAP loss per share will range from a loss of $0.33 per share to a loss of $0.31 per share, assuming a fully-diluted average share count of 14,442,000 shares.

I will now turn the call back to Phill for his thoughts about Everspin's market and our longer-term outlook.

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Thank you, Jeff. With this being our first public company conference call, I want to spend a few minutes providing an overview of Everspin, our go-to-market strategy, business drivers, and investment proposition.

Our MRAM, or magnetoresistive random access memory, solutions are unique in that they offer the non-volatility or persistence that you would normally get in a typical flash product with the endurance and speed of a RAM product such as SRAM or DRAM. Our products are used in a variety of applications including enterprise storage, transportation, and the automotive industry.

A key to understanding why our MRAM products have been adopted by over 600 customers worldwide and why we've been able to ship over 60 million units is because our technology does not replace other memory solutions, but our MRAM solutions also simplify and shorten development time, reduce the customer's bill of materials, and provide superior reliability while, in many cases, improving system performance.

We have a substantial IP portfolio: over 300 patents in place today and another 150 applications pending. We have established a very strong ecosystem of SSD and RAID controllers to enable customers to deploy our latest ST-MRAM products.

Very importantly, we have a first-mover advantage as Everspin is the only company shipping commercially-viable MRAM products today. We believe Everspin is well-positioned and our scalable MRAM technology has the potential to be an industry disruptor.

So why now? There's five key reasons. First, there is now an increasing demand for nonvolatile products that write at high speeds and offer high endurance. You can see this demand growing in the enterprise storage market and with the advance of ADAS and assisted driving features in automotive.

Second, we now have a scalable technology with our proprietary pMTJ ST-MRAM being qualified for production through our GLOBALFOUNDRIES relationship on their 300 millimeter wafers. GLOBALFOUNDRIES has also introduced the use of our technology for embedded memory to be deployed first in their 22 nanometer FD-SOI with a roadmap extending eMRAM to smaller geometries such as 12 nanometer and 14 nanometer in the future.

Our GLOBALFOUNDRIES relationship not only provides Everspin with industry-leading CMOS technology and 300 millimeter production line to expand our product portfolio, but it also provides us with a potentially attractive embedded royalty business opportunity.

Third, by adding new higher-density products starting from 64 megabit to 256 megabit and up to 1 gigabit, we can now address a much larger application base that we estimate is $1.2 billion above the addressable market for our first-generation MRAM or persistent SRAM and serial interface products. Cumulatively, with our 200 millimeter products and 300 millimeter products we can address a $1.7 billion market by 2018.

Fourth, we have put in place an ecosystem that is absolutely critical to be able to rapidly get products transitioned from product samples, qualification, and to production on customers' board. That ecosystem begins with IP cores offered with leading FPGA products and from IP providers, such as Cadence and Northwest Logic, that enables SOC development of SSD controllers and RAID controllers from companies like Marvell, Microsemi, and Broadcom.

And, finally, the fifth reason we feel that our MRAM products are well-positioned for growth is our customer relationships and our design win pipeline that have been enabled by the above items, which I will now address. Taken together, these five factors have allowed us to establish a significant design-in pipeline. We are now focusing on delivering a production-qualified product that will enable us to begin converting customer opportunities in the pipeline into design wins and, ultimately, revenue when the customers launch their new products.

Our first-generation product is targeted to address persistent SRAM applications. The sweet spot for memory densities in this space range from 128 kbits up to 16 megabits. In simple terms, persistence means they require a battery or other power source to be attached to their SRAM, so we are not simply replacing the SRAM, we are eliminating the bill of materials that is needed to make the SRAM persistent and behave as our MRAM products do.

Our second- and third-generation products introduce density levels that now allow us to pursue persistent DRAM applications. We have focused and optimized our persistent DRAM products to address the needs of the enterprise storage and server SSD and RAID write caching and write buffering.

We have already started sampling our 256 megabit device, which has been demonstrated at the Flash Memory Summit with the new Flashtec SSD controller from Microsemi. It has also been demonstrated at the OpenPOWER Summit with IBM's OpenPOWER [Contuto] platform. And as I mentioned earlier, our 256 megabit product was recently launched into the world's first M.2 storage module supplied by Aupera Technologies.

With samples out for evaluation in over two dozen customer projects, we are expanding sampling to customers with our 256 megabit product and we continue to execute our plan for production release within the first quarter of next year. We believe that once this product is released for production we will begin to see a portion of these customer projects in the pipeline begin converting from the opportunity or prospect stage to design-ins, some of which will lead to volume production for us in the second half of 2017.

There is a lot of different emerging memory technologies that are being developed today that have promise for various use cases. Everspin's ST-MRAM products provide an ideal solution today as a storage class memory because it has two necessary attributes. Those are write speed and endurance.

Without the write performance and sufficient endurance the memory will likely require wear leveling. For high-performance use cases, it's much more difficult to use such a memory in an application such that we are focused on. That is the write caches and write buffers for SSDs and rates.

Our ST-MRAM products offer approximately 10 million times more the write endurance of NAND and has about 1,000 times faster write speed than alternative emerging memory technologies. While the other technologies might have advantages in other areas such as density, they don't have the critical attributes to be able to replace the DRAM used for write caching in today's SSD and RAID products. Everspin's products have been specifically optimized to target these applications and use cases.

Design wins for our first-generation technologies typically involve one chip per system and range from somewhere between $50,000 to $1 million per design win, depending on the application and the density of the chip being used. Our second- and third-generation solutions open up opportunities of anywhere between five to nine chips per system, giving us design win potential across numerous customers that are providing server and storage solutions for data centers.

These new design opportunities can provide a significant growth for Everspin as the average revenue per design win can range from $5 million to $20 million per design win.

Everspin's first-generation products are focused on industrial, automotive, and enterprise storage markets. Design wins in these markets typically remain in production for up to three to 10 years and in some cases longer for some automotive and industrial products. This provides us with a stable and growing business to build upon.

Siemens and Schneider are two of our leading industrial customers who use our product in building and factory automation. Our products are also being used in numerous PLC and single-board computer-based systems, from casino gaming and smart metering to factory automation, where there is a critical requirement to operate in a harsh environment and to be able to provide persistence for continuous data logging of critical information or financial transactions.

In all of these applications there is a need for fast writes and high endurance. In the automotive and transportation market, we have design wins that are in production for major aircraft manufacturers, with large foreign automobile manufacturers as well. In automotive, we are used in infotainment systems for Sirius vehicles we've been used in engine control units for high-performance vehicles.

With the increasing demand of high-speed writing and high endurance for automotive, we recently have worked together with Ford to highlight the advantages of MRAM and embedded MRAM in future automobiles. This white paper can be found on our website.

We continue to expand our opportunities with numerous major automobile electronics providers as they provide and develop their offering for more assisted driving features, ADAS, and autonomous driving. These features are a perfect fit for our first-generation MRAM products, providing the critical function of logging data and, in some cases, video.

Finally, there is the enterprise storage market. I would like to emphasize that this market is where our expected future growth will be fueled by introduction of our two newest products based on our third-generation proprietary pMTJ MRAM technology. These are the 256 megabit DDR3 and 1 gigabit DDR4 products which we discussed earlier. Our value proposition in storage is to provide a power failsafe write cash or buffer that improves reliability; eliminates a complex solution requiring capacitors, super gaps, and in some cases batteries; frees up space to potentially improve performance or to increase the overall capacity of the SSD or flash array.

In the enterprise market, having an established track record of quality and delivery has allowed Everspin to establish solid relationships with our customers. On average we ship about 40% of our first-generation product to customers building enterprise-class storage solutions with a strong position in RAID systems.

We are in a very exciting time in our history with all of the industry-first MRAM products already in production, in development, or preparing for production qualification. Our focus is now on execution as we continue to convert opportunities in the design win pipeline. We have the most experience in the industry with delivering new MRAM products into production. This, along with a solid sales and operational team to support our customer and an outstanding manufacturing and ecosystem partners such as GLOBALFOUNDRIES to support our production requirements, has positioned the Company well for growth.

Before we move on to the Q&A session of the call, I want to reiterate Everspin's strengths in the MRAM market. We're the first and only in the market to deliver not one, but three generations of MRAM technology and products. We've established a manufacturing partnership with GLOBALFOUNDRIES that not only provide the production capabilities for our products that ensure that we can deliver reliably to our customers, but also opens up an embedded business model opportunity that we believe can generate additional profits for the Company in the future.

We have spent a lot of time building our customer relationships, which we highly value, as these customers have led us to create a very powerful ecosystem and to define new products that will bring value to them and for their customers. All of this together we believe will allow Everspin to drive growth in our revenue for the future. We believe that by focusing on optimized memory solutions for specific application requirements can allow Everspin to maintain similar margins to those which we've achieved in our first-generation products and provide Everspin and its shareholders with an attractive opportunity for long-term growth model with healthy profits.

In closing, I want to acknowledge the entire Everspin team, who have worked tirelessly up to and through our IPO process. Their dedication to make Everspin a stronger company with an exciting future ahead is extraordinary and I salute their efforts. In addition, I also want to reiterate my thanks to our ecosystem and manufacturing partners, suppliers, customers, and investors for their continued support.

Now we will open the call up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Matt Ramsay, Canaccord Genuity.

Matt Ramsay - *Canaccord Genuity - Analyst*

Thank you very much. Good afternoon, guys, and congratulations, obviously, on the IPO. It's good to see the first quarter out.

A few questions from me, if I could. I guess, first of all, the predominance of the product revenue today. And I think the way that you guys presented the revenue here in the script was growth of product revenue for the emerging businesses led by the Gen 1 MRAM product with the catalyst being automotive and a decline of legacy products.

Since it's the first public call, maybe we could talk about the mix of the current revenue that was I guess future growth products versus the mix that was legacy products and how you see those trending, not just in the guided quarter but going forward into 2017?

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Do you want to take that, Jeff?

Jeff Winzeler - *Everspin Technologies, Inc. - CFO*

Sure. Matt, within the product sales that we report on the P&L, as we talked about, we have what we call Gen 1 MRAM which is exactly that, our first-generation MRAM products, and then we have what we call legacy. And in legacy I lump a couple of products that the Company has been involved with in the past but has not invested new resources in terms of new designs or products. And those take the form of foundry services as well as the sensor business. We have a pretty large sensor IP patent portfolio and we are not generating new sensor products for sale as discrete products.

So when you look at the product mix of Gen 1 MRAM versus legacy, 80%-plus of our product revenues today are driven by the Gen 1 MRAM. That has continued to grow quarter over quarter and year over year. The legacy products, on the other hand, are experiencing declines because we're not investing in more of those. The effect of that is it looks like our total product revenues aren't growing at the rate that our Gen 1 MRAM is.

With regard to the legacy products also, for example on sensor, rather than focus on discrete sales of those products in the future, we are moving to a model where we license our IP technology in sensor. And future revenues in that market will primarily come in the form of royalties off that licensing revenue.

Matt Ramsay - *Canaccord Genuity - Analyst*

Great, that's helpful. Thanks, Jeff.

Phill, I see that you guys have got initial wafers back from the 1 gig MRAM part, so congratulations on that. Maybe you could talk about the roadmap a bit. You reiterated confidence in the 256 and the Gen 3 1 gig parts in the script. Now that you've gotten the first wafers back on the 1 gig parts maybe you could just give us an update on the roadmap and how you feel things are progressing as those are the big drivers of future growth. In the assumptions that I've made in my model, anyway.

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Sure. First and foremost, the 256 megabits DDR3 part is the focus that the team has right now to put that part into production within the first quarter of next year. That is obviously going to be the product driving design win conversion in 2017 and so we continue to focus on that and we see that we are continuing to be on track for that plan.

With regards to the 1 gigabit chip, what we were able to accomplish was, of course, tape out the chip and get the first wafers fabricated. In fact, last week during the electronica show we were able to display the very first wafers coming off the line. Now those wafers are still going to need to be wafer probed and processed and assembled and tested, and the plan is to get those into our lab before the end of this year for the first testing by our team.

Until we are able to do that we're not really updating too much more than we have for the 1 gigabit plan, but as far as the plan goes moving forward, it is currently on track with what we've talked about previously.

Matt Ramsay - *Canaccord Genuity - Analyst*

Got it, got it. Obviously, Jeff, a lot of moving parts with the R&D number in the quarter that you guys reported with the different one-time items. So maybe you could just talk a little bit about the operating expense run rate you expect going forward. Particularly on the R&D line and how we should think about modeling that, that would be really helpful. And I will jump back in the queue, thanks.

Jeff Winzeler - *Everspin Technologies, Inc. - CFO*

I think I noted in the call, Matt, that we had two specific events that really drove reduction of about $3 million in our run rate of spending for R&D. The two items primarily were: as I indicated, we had this kind of lull in our investment in test and development wafers for product development. In my comments I noted that that is not typical and I think if you look back at Q1 and Q2 of this year, you will see R&D rates that were above where we were in Q3.

The other one was a very one-time deal, which had to do with the mark-to-market valuation of the GLOBALFOUNDRIES shares. In Q2, our expense associated with this line item was $900,000 and in Q3, because we had to do a mark-to-market in Q3 and we used the IPO pricing, we actually have a credit of $693,000. So you can see that's about a $1.6 million swing in terms of what I would call run rate spending.

And going forward, when I think about Q4, what will happen in terms of valuing those shares is just the shares that vest in a given quarter are actually priced at the market price of the shares for the quarter. So we won't see credits in R&D spending for GLOBALFOUNDRIES shares going forward. We will return back to kind of a run rate of spending associated with those that we've seen in previous quarters.

Matt Ramsay - *Canaccord Genuity - Analyst*

Got it and congratulations. I have more questions, but I will get back in the queue. Thanks, guys.

Operator

Robert Mertens, Needham. Mr. Mertens, your line is live; you may ask your question.

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Let's move on to the next questioner.

Operator

Dean Grumlose, Stifel.

Dean Grumlose - *Stifel Nicolaus - Analyst*

This is Dean Grumlose calling in for Kevin Cassidy. Thank you very much for taking my call.

If we could return to the 256 megabit device for a second. You had mentioned a production in Q1, but more substantial revenues in the second half of next year. Is that because you're just ramping the production or is the revenue later in the year because that's the timing of the actual customer system?

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

So the product has been slated to be qualified for production within Q1 so we have been sampling the products through various customers, as I highlighted earlier. They are obviously out testing in various configurations and boards or systems.

Most of these opportunities that if they are considering the product for will typically not convert to a design win or award a design win until Everspin qualifies the product for production. Again that is expected to be completed in the Q1 timeframe.

After that is done, then various customers will have timelines in which they can launch a product, depending on how much advanced work they did with our samples. And that's what we expect to start ramping and providing some revenue for us in the latter part of the second half of 2017.

Dean Grumlose - *Stifel Nicolaus - Analyst*

As a follow-up, how should we think about the 1 gig device? Would that be, as best you know, possibly revenue at a year later, towards the latter half of 2018, or might that be potentially pulled in?

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

I think you've got it basically right. The perspective we have is that the 1 gigabit -- obviously we're going to be getting our first in-house samples at the end of this year. We have to evaluate that and determine whether or not there is a revision of the product that is required or not, and then we will be providing some outline to our customers as to when sample availability would be for them to start testing.

Our expectation would be that the 1 gigabit opportunities wouldn't start creating revenue momentum until the second half of 2018.

Dean Grumlose - *Stifel Nicolaus - Analyst*

Great, that's very helpful. Thank you very much.

Operator

Robert Mertens, Needham.

Rajvindra Gill - *Needham & Company - Analyst*

This is not Robert Merton. It's Rajvindra Gill. I don't know why your operator is not getting my name correct. (multiple speakers) No, no, no; it's a little bit strange.

My question is on the second-generation product. It's going to be qualified in Q1 with volume production in the second half of 2017. I wanted to get a sense of the ecosystem that is being developed and the design wins that you are hoping for with that second-generation MRAM product.

Can you talk about where we are with the design engagement process? And from the end-customer perspective as well; are they looking to start deploying MRAM in their systems? If you could just talk about that process, that would be helpful as well.

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Sure, Raj. Just to clarify, the products that we are focusing on going into production here in the second half of 2017, the 256 megabit, is our Generation 3 product. And so the Gen 3 256 megabit has been sampled out in probably over two dozen different customer project opportunities.

What has enabled that has been the work that the team at Everspin has done creating and establishing an ecosystem with partners such as FPGA providers, SSD controller companies; fairly mainstream such as Microsemi or Marvell. And also in the RAID market with the Broadcom or Microsemi based RAID controller or ROC chips.

So by establishing controllers in both of those segments and with FPGAs it has allowed our customers to set up test boards, evaluation boards, and in some cases, actual product boards that they can drop in our samples and begin evaluation of the product. And even in some cases developing firmware and starting to gauge performance of the technology.

We have already had some use cases. For example, at the IBM OpenPOWER Summit where they have used our DIMMs in their server and have already published improved application performance based on using the technology.

So our expectation is that these customers will continue using the samples we have provided and we will continue to provide those samples up and to the point where we are now converting it into a production-qualified part, which would be in the first quarter of next year. Then at that point -- and obviously between now and then we are going to be working with various customers to determine when they are going to be ready to produce an actual system or ship a card that would have MRAM on it. And that is something that would be more likely to materialize and be clear in the first quarter of next year.

Rajvindra Gill - *Needham & Company - Analyst*

Okay. So to reiterate, you have a pipeline of opportunities for 256 megabit with SSD market providers or RAID providers, but you will start announcing design wins possibly when you release the production of the qualified 250 megabit samples, which is end of -- Q1 of 2017? Is that when you will start talking about the design wins?

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Obviously, when the customers get a production-qualified part that's when they would be able to confirm to us a specific project that they are going to launch with. So we have programs identified and their ongoing evaluation, but until they see a production qualified product -- in other words, released for production -- they are not likely to make an announcement of a particular product using our MRAM.

So that's something that's going to be triggered as soon as we provide notification that the part has been qualified for production. We expect that to start happening within the first quarter or shortly thereafter, once we announce the part is production qualified.

Rajvindra Gill - *Needham & Company - Analyst*

And then the likelihood from the production-qualified product to actual revenue; how would you characterize that and which customers -- IBM, Western Digital, Huawei?

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

We are not at a point where we can discuss a specific customer name, but we can certainly say that in the SSD market is where we expect the immediate or near-term design traction to occur in for the 256 megabit. And that again, I would say, is predominantly driven -- that time from when

they announce that they are going to move forward to when they launch is going to be really a function of the valuation that they have been doing since we have been giving samples to them this past August, up to the point of the end of Q1 or Q2 of next year.

Some of them will get a lot of their work done just using our samples that we have given up to this point and others may need additional time to get a product launched and into production. So our expectation is we will see some of these designs convert in Q3 and probably a larger portion of the opportunities that will go to production will probably be happening late Q3 or Q4.

Rajvindra Gill - *Needham & Company - Analyst*

Okay, great. Thank you.

Operator

Matt Ramsay, Canaccord Genuity.

Matt Ramsay - *Canaccord Genuity - Analyst*

Thanks, guys, for letting me jump back in. Jeff, I wanted to talk a little bit about two things. One, from a financial perspective, gross margin really, really strong in the quarter. You mentioned some royalty revenue that helped that out and also mix.

Maybe in the quarter that you've guided to you could talk a little bit about how we should model gross margin. And then holding margins above 50% I believe is still the plan as the Gen 3 and further products ramp, but I just wanted to reconfirm all of that. And any help on gross margin in the near term would be helpful, thanks.

Jeff Winzeler - *Everspin Technologies, Inc. - CFO*

Yes, sure. So the single largest swinger of gross margin for us is usually product mix. In Gen 1 MRAM we have eight or so specific product families that make up Gen 1 MRAM and each one of those has a very different gross margin profile. And so the mix of those products, along with the two legacy products that we have, strongly drives what our gross margin percentage is quarter over quarter.

And if you look historically through 2016, you will see in Q1 we were at 59%, Q2 we were roughly 53%, and then this quarter we were 60%. That really shows you the kind of fluctuation that we get based primarily off that product mix.

In terms of looking forward, I can't predict exactly what that product mix will be. We have always stated that our target margins for the business are typically 50% or greater. If you look at kind of history there, we have run at mid-55%, 54% for the year on a nine-month average.

With regard to the longer-term product gross margin target, our target P&L is -- continues to have margins that range from basically 49% up to 53%, 54%. So we always try and target businesses or opportunities for our current generation of product at opportunities where we can earn 50% or greater gross margin. And we expect that to continue with our Gen 3 products as well.

We are pricing the product based on the value that we see in the market. And we are taking advantage of opportunities where we can sell that product into markets that we can earn that target range of 49% to 53%, 54% margins.

Matt Ramsay - *Canaccord Genuity - Analyst*

That's really helpful, thanks. Just the last question from me, it looks like, Phill, about 9% growth for the first three quarters of the year for Gen 1 MRAM. And at least my expectation is for some of the increasing demand in the automotive market to hopefully inflect that growth rate a bit higher as we move forward.

Maybe you could talk about the pipeline of Gen 1, particularly in the automotive space and the particular applications and perhaps OEMs, if you can name them, that are driving a hopeful reacceleration in that business. Thanks, guys.

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Matt, the Gen 1 product revenues are still dominated in this calendar year by the business that we do in enterprise storage, which is predominantly RAID, and by the large customer base that we have in the industrial market space.

The automotive side of it is growing for us, but most of that is in design win traction that we are expecting to generate revenue further out in time. As you know, the automotive applications, they start selecting and engaging in design activity sometimes three to four years prior to production. So we are in the process of discussing with numerous automobile manufacturers or electronics companies that work with the automobile industry about various opportunities for data logging functions using our first generation.

We don't expect that big inflection in the numbers until probably out in 2018 or 2019. We do have customers today that are increasing the use of our product.

We have a large foreign automobile manufacturer in the Far East that has adopted our parts in upwards of 13 different vehicles. They are also now looking at expanding from the infotainment area that we are designed in originally on one car and then it, thus, expanded to more than -- as I said, around 13. They are now looking at deploying us in various assisted driving features, but again those won't ramp up into production until probably 2018 or 2019 timeframe.

Matt Ramsay - *Canaccord Genuity - Analyst*

Got it, that's really helpful. Thanks, guys.

Operator

(Operator Instructions) Richard Shannon, Craig-Hallum Capital.

Richard Shannon - *Craig-Hallum Capital Group - Analyst*

Great, glad I could finally get in the queue here. Not sure what was going on there, but thank you for taking my questions, Phill and Jeff.

Maybe I will follow-up on a couple of questions I heard earlier in the Q&A session here, maybe to recharacterize or characterize the environment here for your 256 devices you are expecting to ramp up in the latter half of next year.

Phill, can you discuss the breadth of the customer base and the design base here? Is this -- do you expect this to be two to four or five customers or closer to a dozen? And how many different designs do you expect to have ramped up by the end of next year?

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

Well, that's a tough number to predict. As I highlighted before, we have shipped out enough samples now for over two dozen various customer projects, all of them are at somewhat different stages of their deployment or development. Some customers, obviously, are looking at fast-tracking opportunities and others are still in the early stages of evaluating or developing firmware for deploying a product.

So I think it would be really hard for me to predict a specific number of customers that are going to convert and the precise timing of them, especially because it's still kind of early with many of these customers. Some of them received samples sometime in late August and others are just getting samples within the last 30 days or so.

So what I could say is that the focus -- most of these companies are in the SSD area or some type of flash array-based product. Again, they are looking at the use of the MRAM with one of our ecosystem partner controllers, one or another, or they may have their own controller that they have put together and have incorporated the DRAM interface IP necessary to recognize and take advantage of our MRAM.

Conversely, some of them could be using an FPGA. We have qualified with the large FPGA providers a DRAM interface that is also compatible with our MRAM. Again, I think you can take the focus of most of the design wins being SSD or flash array. And, again, it's going to be hard to give you that number probably until we are in Q1 of next year, as some more of these opportunities get a little bit firmer with the customer schedules.

Richard Shannon - *Craig-Hallum Capital Group - Analyst*

Okay, that is helpful. Thanks for that, Phill.

My second question is just following up on something I think I heard in the prepared remarks, but again my audio quality may not been great. I think you said that within your Gen 1 product family you are generating about 40% of those sales from the enterprise market.

Curious how you see that mix of business within Gen 1 transitioning throughout next year. Do you see any other categories becoming much larger percentage Gen 1 or do you kind of see it being consistent to what it is today?

Phill LoPresti - *Everspin Technologies, Inc. - President & CEO*

So you did hear that correctly; about 40% of what we provide and ship is going into enterprise storage and that's specifically RAID metadata logging functions. Right now our view of that is, first and foremost, it does not get cannibalized by our spin torque or ST-MRAM products. This data logging function would continue independent of whether or not the RAID system would adopt an MRAM for its write caching or otherwise.

We have also deployed new products that were specifically targeted for the next generation of RAID, RAID on-chip products that are coming out. And we do know that the major suppliers there have qualified our product. They are already testing and evaluating and actually doing some preproduction of those parts, so we expect that segment of our business to stay about the same.

We are expecting, however, that we will start seeing some increase, as I was discussing with Matt's question, in the automotive space. We are gaining more traction and more opportunities there in getting designed in. In this one example with this foreign automaker in the Far East that they are adopting our product in more and more of their series vehicles.

So I think we might see a slight increase in the automotive percentage, but in general I think the RAID system and the storage segment that you mentioned is going to stay pretty much the same.

Richard Shannon - *Craig-Hallum Capital Group - Analyst*

Okay, that's helpful. Thanks for that. My last quick question, actually two parts for Jeff.

I didn't get a chance to run through the model from the guidance for the quarter, but what you expecting for gross margins from the fourth quarter? And do you have any -- can you give us any help in estimating where you expect the cash balance to finish end of the year?

Jeff Winzeler - *Everspin Technologies, Inc. - CFO*

We didn't provide any specific gross margin guidance for Q4. What we did talk about was the fact that our gross margin percentage is highly variable based on the product mix sold in the quarter.

Again, we have roughly eight different product families within Gen 1 and MRAM. Each of those has a different gross margin profile. They have different yields, different die sizes, etc. So our overall gross margin mix is very -- is highly variable depending on the mix of products that we sell. And then you throw on top of that we've got legacy products that have their own gross margin profiles as well, so the overall product mix changes quite a bit from quarter to quarter.

The other variable there is anything that we sell in licensing and royalty typically will swing our gross margin. And in fact, in this quarter we had an uptick of about $90,000 of licensing and NRE revenue, which gave us about another point on our overall corporate gross margin.

So I think, while we didn't give specific guidance relative to Q4, you will see quite a bit of variation from Q1 to Q2 to Q3 of this year. And I think over a year's timeframe that tends to kind of wash itself out and give you the run rate, if you will, of what our gross margin is.

Richard Shannon - *Craig-Hallum Capital Group - Analyst*

Okay, that's helpful. Then just, Jeff, on the cash burn or the expected cash ending point for this quarter.

Jeff Winzeler - *Everspin Technologies, Inc. - CFO*

So, luckily, right after the end of this quarter our $2 million balance went up significantly, due to the IPO and thanks to all the new investors and the private placement.

The thing that we have talked about in the past is that our burn rate, based on our current sales trajectory, is a little over $1 million to $1.1 million per month in terms of operational cash burn. We will have one big expense in Q4.

We noted in the S-1 and the IPO that part of the proceeds would go to pay off the GLOBALFOUNDRIES joint development agreement expense and you see that in deferred liabilities on our balance sheet today. So that will be a very large one-time payment that you will see in Q4. Then, on average, given our sales run rate, probably another $1.1 million of operational cash burn.

Richard Shannon - *Craig-Hallum Capital Group - Analyst*

Great, that's very helpful, Jeff, and that's all the questions for me, guys. Thank you.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Jordan Darrow for any closing remarks.

Jordan Darrow - *Darrow Associates - IR*

Thank you, operator. Everspin will be participating at the Craig-Hallum conference this Wednesday and we look forward to seeing many of you at this event. A webcast of our presentation at the conference for those who will not be in attendance can be seen on the investor relations section of our website at www.Everspin.com.

Thank you for your interest in Everspin and goodbye for now.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.
