Impinj Second Quarter 2020 Earnings Conference Call
Wednesday, July 29, 2019
5:00 p.m. ET / 2:00 p.m. PT

Ellen Hayes-Roth, INVESTOR RELATIONS FOR IMPINJ

Thank you, Operator. Good afternoon, and thank you all for joining us to discuss Impinj's second-quarter 2020 results. On today's call, Chris Diorio, Impinj's co-founder and CEO, will provide a brief overview of our market opportunity and performance. Cary Baker, Impinj's CFO, will follow with a detailed review of our second-quarter 2020 financial results and third-quarter 2020 commentary. We will then open the call for questions. Jeff Dossett, Impinj's Chief Revenue Officer, is also on the call and will join Chris and Cary in the Q&A session. Management's prepared remarks, along with trended financial data, are available on the investor-relations section of Impinj's website.

Before we start, please note that we will make certain statements during this call that are not historical facts, including those regarding our plans, objectives or expected performance; the expected or potential impact of Covid-19 on our business, operating results, financial condition or prospects; and the expected or potential responses of government authorities, customers, partners and the company to Covid-19. To the extent we make such statements, they are forward-looking within the meaning of the Private Securities Litigation Reform Act from 1995. Any such forward-looking statements represent our outlook only as of the date of this conference call.

While we believe any forward-looking statements we make, including concerning Covid-19, are reasonable, our actual results could differ materially because any statements based on current expectations are subject to risks and uncertainties. Please see the risk factors in the annual and quarterly reports we file with the SEC, and risk factors in the Form 10-Q we filed today, for more information about these risks. We do not undertake, and expressly disclaim, any obligation to update or alter our forward-looking statements, whether as a result of new information, future events, or otherwise except as required by applicable law.

During today's call, all financial numbers we discuss, except for revenue, or where we explicitly state otherwise, are non-GAAP financial measures. Balance-sheet and cash-flow metrics are on a GAAP basis. Free cash flow is a non-GAAP measure.

Before turning to our results and outlook, I'd like to note that the company will virtually attend the 9th Annual Needham Industrial Technologies Conference on August 6th, Oppenheimer's 23rd Annual Technology, Internet & Communications Conference on August 11th, Canaccord Genuity's 40th Annual Growth Conference on August 13th and Colliers Securities' Conference on September 10th. We look forward to connecting with many of you at these upcoming events.

I will now turn the call to Chris Diorio, Impinj's co-founder and chief executive officer. Chris.

Chris Diorio, Impinj Co-Founder and Chief Executive Officer

Thank you, Ellen. Thank you all for joining our call. I hope you and your loved ones are and remain safe and well.

Covid-19 has significantly affected Impinj and our customers in the short term, causing unprecedented volatility in the first, second and third quarters of 2020. Looking further out, we believe Covid-19 will accelerate our secular opportunities in the mid to long terms and advance our thesis of connecting and giving digital life to every thing.

Starting with the short term, Covid-19 severely impacted retail apparel, our leading endpoint IC market, with nonessential stores mostly closed. In other markets, Covid-19's impact varied by opportunity and geography but the overall impact was negative. Our inlay partners, adjusting to the volatile demand environment, first expedited endpoint IC shipments from second quarter to first, then rescheduled backlog from second quarter to second half, while also slowing second-quarter bookings. As a consequence, our second-quarter revenue contracted quarter-over-quarter and year-over-year. The rescheduling requests peaked in May, with bookings improving notably in July. Our inlay partners are today consuming inventory they accumulated in the first quarter, and we expect that inventory to normalize by the end of the third quarter. On the brighter side, demand for those endpoint ICs used in industrial, supply-chain and specialty applications, which are smaller but still meaningful opportunities for us, remained steady in second quarter, engendering a richer-than-typical product mix and higher margins. On the systems side of the business, second-quarter revenue also declined quarter-over-quarter and year-over-year, driven by the North American systems project transitioning to its operational phase and capex pullbacks at other end-user projects. The former did bring a bright spot, with the customer ordering more gateways despite the project transition, generating modest second-quarter revenue. For the latter, tight capex manifested in lower deal count and smaller deal size, with many consumer-facing use cases, like race timing and airline baggage tracking, delayed or put on hold. Also, pilots or deployments that required nonessential onsite personnel were similarly put on hold. Finally, our systems distributors are today reducing their inventory levels on lower sell-through and only placing new orders for products or quantities not currently in inventory.

Today, retail stores are reopening in many geographies, particularly in Asia, but productivity remains low, particularly in North America. While the pandemic's apparent resurgence tempers our third-quarter endpoint IC expectations, some large retail deployments continue expanding worldwide, including at a notable North American end user. On the systems side, tightened end-user capex budgets and ongoing slowness in consumer-facing opportunities likewise temper our third-quarter systems expectations. Today's vantage point also suggests that the fourth quarter may not follow typical seasonality.

Turning to the medium term, we see Covid-19 accentuating our opportunity. We saw and felt it even in the depths of the crisis. Visionary RAIN-enabled retailers, with better visibility into their inventories, were able to quickly pivot to online sales and omnichannel fulfillment. Many of those retailers are today accelerating plans to modernize their in-store experience, improve customer satisfaction and reduce vectors for virus transmission. For example, Covid-19 is driving a transition away from traditional loss prevention and toward RAIN-enabled loss prevention, touch-free self-checkout and seamless returns, offering large projects with leading loss-prevention partners and retail end users. In the supply chain, as shipment volumes ramped to traditionally short-lived holiday peaks and stayed there, end users accelerated their plans to modernize their operations. We are today seeing traction not only reading items passing through dock doors, which we have discussed on prior calls, but also on conveyor belts, to reduce manual touch and improve shipment accuracy. Notably, a second large North American supply chain and logistics provider is commencing a deployment with a scale and at a pace that are difficult to forecast but we believe will be significant by most any measure. We expect these accelerating retail and supply-chain and logistics opportunities to not only drive long-term systems revenue, but also significant endpoint IC volumes as deployments transition to operations, mostly in 2021 and beyond. With our strong balance sheet and staying power we will not only weather the impacts of Covid-19, but we will invest in these opportunities and exit the other side of Covid-19 stronger.

Looking to the long term, we believe Covid-19 will accelerate our vision of connecting and giving digital life to every thing. Leading businesses are investing in modernizing their operation to address structural inefficiencies and deliver the seamless ecommerce, online and in-store experiences their partners and customers demand. To do so, they want and need the visibility, insights, virtualization and customer experience that RAIN brings. Our pipeline of large systems opportunities and end-user engagements is richer than, and deeper than, at any time in our history. Leading end users are pushing us to expedite innovations and solutions, not delay them. They are also asking for more and better capabilities, not less. Our engagements with top-tier OEMs, ISVs, SIs and IoT providers are also advancing, as they feel the same pull we do from those large, visionary end users. The game-changing products we have introduced, like the Impinj M700 endpoint IC, and the IoT vision we have advanced resonate in a world forever changed by Covid-19. We are energized by the pace toward realizing our vision and the partners and end users we are driving it with.

Turning to new products, our production ramps were a bright spot in the quarter as we delivered production volumes of our M700 endpoint IC and R700 reader product families. We believe the M700 will fundamentally change the RAIN landscape by proving our ability to migrate an endpoint IC aggressively down Moore's Law, improving performance while at the same time adding new functionalities that were previously out-of-reach. Our partners and end users are excited by both the performance and the first key new functionality, protected mode, which enables embedded tagging for retail self-checkout, loss prevention and seamless returns. We see both the M700 and R700 as growth drivers, affirming our position as the leading RAIN innovator and product supplier now and in the future. The R700 also received recognition for its creative design in the 2020 Core77 Design Awards. The Impinj M700 and R700 are centerpieces of our platform and powerful growth drivers for our business. We remain committed to further innovation across all our product lines.

On the organizational side, second quarter brought both excitement and introspection. Excitement in Jeff Dossett's promotion to Chief Revenue Officer. Jeff brings tremendous insights and leadership running our go-to-market organization. He has been instrumental in our sales, partner and product successes and we foresee continued excellence. Congratulations, Jeff, on your well-deserved promotion. We are also happy that, from a team perspective, we adapted well to our virtual work environment and have maintained our productivity. Employee retention was high and we added talent to a few targeted areas. But second quarter also brought deep introspection. George Floyd's murder on the evening of the United States' Memorial Day, May 25th, 2020, exposed those of us, me included, who were silent on racism as part of the problem. Today, we can be silent no more. The next day I wrote a letter to all Impinj employees, closing with these words "Together we can commit to not let today's events fade from our memories, as has happened so often in the past. To strive instead for the better, and to dedicate ourselves in doing so". In response, so many of our employees committed to making our company a model of diversity and inclusion that I am confident that they, and we, will make it so. And we, all of us, will not forget.

In closing, second quarter was challenging, and Covid-19's immediate impact will extend into the third quarter. Regardless, we remain focused on emerging from Covid-19 a stronger company in a stronger market position than when we entered it. As I said last quarter, we have not lost sight of the big picture, of the benefits we bring to retailers and of the improvements we can drive in supply chain and logistics. And we see brightness ahead, with adoption accelerating as leading end users leverage the visibility, insights, virtualization and customer experience that RAIN brings. With a strong balance sheet, game-changing new products and a compelling platform and vision that sit squarely in the center of end-user business transformations, our future is bright. We will continue focusing on leading apparel retailers and on leading supply-chain and logistics companies, investing in operational improvements for them and business opportunities for us. We will do so with a fierce determination to win, keeping a close eye on expenses as we leverage our resources to increase our competitiveness and chart a path to adjusted EBITDA breakeven on the other side of Covid-19.

Be safe and be well. I will now turn the call over to Cary for our detailed financial review and second-quarter commentary. Cary.

Cary Baker, Impinj Chief Financial Officer

Thank you Chris, and good afternoon everyone.

Today, I will cover both the metrics we typically discuss on earnings calls as well as additional, more detailed metrics, which we believe are appropriate given the market uncertainties.

Second-quarter revenue was $26.5 million, declining 30.7% year-over-year and 44.7% quarter-over-quarter, compared with $38.2 million in second-quarter 2019 and $47.8 million in first-quarter 2020.

Second-quarter endpoint IC revenue was $18.5 million, declining 21.8% year-over-year and 44.9% quarter-over-quarter, compared with $23.7 million in second-quarter 2019 and $33.7 million in first-quarter 2020. Second-quarter endpoint IC bookings declined significantly year-over-year and quarter-over-quarter, driven by inlay partners rescheduling backlog and managing inventory levels in this new demand environment. We expect our inlay partners to take advantage of the recovering retail demand environment in the third quarter to reduce the inventory they built in first-quarter 2020. While that dynamic, coupled with customer-specific adjustments, will limit our third-quarter revenue recovery, we see positive momentum in our bookings pace. As of July 24th, July bookings have improved significantly over June and are higher than any month in the second quarter, and we still have a week of July to go. We expect our customers to complete their supply-chain inventory adjustments in the third quarter and that our fourth-quarter endpoint IC revenue will be more indicative of end-user demand.

Second-quarter systems revenue was $7.9 million, declining 45.4% year-over-year and 44.1% quarter-over-quarter, compared with $14.5 million in second-quarter 2019 and $14.1 million in first-quarter 2020. Gateway revenue declined both year-over-year and quarter-over-quarter, led by the large North American project transitioning to an operational phase, with modest revenue from that customer in the second quarter. Reader revenue declined year-over-year and quarter-over quarter, impacted by Covid-related project delays and tight customer capex budgets. Reader IC revenue grew year-over-year and quarter-over-quarter due, in part, to modest partner inventory builds to reduce supply risk. We expect third-quarter systems revenue to remain constrained by continued tight capex budgets, our distribution partners rationalizing their inventory levels for lower sell-through, and by lower reader IC revenue, the latter due, in part, to reduced demand for retail handhelds.

Second-quarter gross margin was 51.4%, compared with 50.0% a year ago and 46.1% last quarter. On a year-over-year basis, gross margin improved 140 basis points, driven by underlying product margins partially offset by leverage on lower revenue. On a quarter-over-quarter basis, gross margin improved 530 basis points, driven by lower E&O charges and improved underlying product gross margins, partially offset by leverage on lower revenue.

Total second-quarter operating expense was $18.8 million, compared with $18.3 million in second-quarter 2019 and $19.0 million in first-quarter 2020. Research and development expense was $8.6 million. Sales and marketing expense was $4.8 million. General and administrative expense was $5.4 million.

Second-quarter adjusted EBITDA was a loss of $5.2 million, compared with a profit of $800 thousand in second-quarter 2019 and a profit of $3.0 million in first-quarter 2020. We have excluded costs of $5.4 million associated with an expected settlement of our shareholder class-action lawsuits from second-quarter non-GAAP general and administrative expense, adjusted EBITDA and non-GAAP net loss.

Second-quarter GAAP net loss was $17.5 million. Second-quarter non-GAAP net loss was $5.6 million, or 25¢ per share, using a weighted-average diluted share count of 22.7 million shares.

Turning to the balance sheet, we ended the second quarter with cash, cash equivalents and short-term investments of $120.9 million, compared with $59.8 million in second-quarter 2019 and $119.2 million in first-quarter 2020. Inventory totaled $37.1 million, down $800 thousand from second-quarter 2019 and increasing $5.3 million from first-quarter quarter 2020. The quarter-over-quarter inventory increase was driven by lower demand due to Covid-19 as well as the production ramp of the Impinj M700. In second-half 2020, we will maintain adequate supply of our 200mm endpoint ICs as we set the stage for our transition to the 300mm M700 family.

In the second quarter, net cash provided by operating activities was $1.0 million and property and equipment purchases totaled $100 thousand. Free cash flow was $800 thousand.

I will now highlight a few items impacting our business. First, our suppliers that operated at reduced capacity or were closed due to temporary government mandates have recovered. They are today operating at nearly 100% capacity, but we continue to be vigilant around component availability in a dynamic demand environment.

Second, we have an agreement to settle all outstanding shareholder litigation. We recorded a $5.4 million settlement-related expense in our second-quarter GAAP general and administrative expense and we expect a corresponding cash outflow during third-quarter 2020. After considering a number of factors, including the significant expense of protracted litigation of this type, in time and money, we determined that it was in company’s and its shareholders’ best interests to settle the suits. As Chris noted, we have significant opportunities ahead of us and we look forward to focusing on enabling digital life for every thing.

Third, in the second quarter, we generated positive free cash flow from strong underlying product mix boosting gross margins and the team effectively managing operating expense, working capital and capital expenditures. Looking into third quarter, those benefits will reverse. Operating expenses will increase, working capital will consume cash, capital expenditures will increase and underlying product mix will be less favorable. While we will use our balance sheet in the third quarter to fund our business, we remain confident in our plan to return to adjusted EBITDA breakeven on the other side of Covid-19.

Turning to our outlook, considering the ongoing impact of Covid-19 on our partners and end users, we feel it is prudent to not give quantitative third-quarter guidance. Instead, we will share additional metrics about our business that we do not intend to share on an ongoing basis. As of July 1st, third-quarter backlog scheduled to ship in quarter was $16.2 million. In addition as of July 24th, third-quarter bookings scheduled to ship in quarter were $7.0 million, up 20% quarter-over-quarter and down 17% year-over-year. Further third-quarter upside is limited both by continuing demand volatility and by our partners rationalizing their endpoint IC and systems inventory levels.

Despite the third-quarter uncertainty, we see encouraging signs as our partners and end users recover in the new demand environment. We remain focused on emerging on the other side of Covid-19 a stronger and more competitive company, delivering against the new opportunities that Covid-19 is creating.

In closing, I want to thank our Impinj team, our customers, our suppliers and you, our investors, for your ongoing support in these uncertain times.

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