Impinj Third Quarter 2020 Earnings Conference Call
Wednesday, October 28, 2020
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 third-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 third-quarter 2020 financial results and fourth-quarter 2020 outlook. 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, except for net cash used in operating activities. Free cash flow is a non-GAAP measure.

Before turning to our results and outlook, I'd like to note that the company will participate in the Roth Technology Virtual Conference on November 12th and the 23rd Annual Needham Growth Conference on January 13th. 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.

Third-quarter revenue improved sequentially, driven primarily by rebounding retail-apparel volumes that drove endpoint IC sales. Many of our market segments remain impacted by Covid-19, so total revenue remained below third-quarter 2019. Regardless, we remain excited about our opportunities in both endpoint ICs and systems as we look forward into 2021.

Endpoint IC revenue increased sequentially in the third quarter, aided in part by customer requests to reschedule second-quarter 2020 backlog to second half. Year-to-date endpoint IC revenue was up 2.6%, marked by first-quarter strength from market demand and customer expedite requests, second-quarter weakness due to shutdowns and third-quarter demand recovery tempered by inventory reduction at our inlay partners, the latter essentially normalized by quarter end. Looking to the fourth quarter, we anticipate sequential revenue growth despite typical seasonal declines. We shipped more than 100 million Impinj M700 endpoint ICs in the third quarter and now, with multiple inlay partners receiving approvals from Auburn University's testing lab, we see our opportunities expanding. We anticipate more certifications in the fourth quarter and accelerating M700 adoption and volume growth.

Third-quarter systems revenue declined sequentially, with Covid-19 impacting demand in retail, automotive and consumer-facing use cases such as travel and sports. Compounding that reduced demand, our reader and reader IC distributors continued reducing their inventory to match the new demand, fulfilling orders where they could from inventory on hand. We anticipate further fulfillment from distributor inventory in the fourth quarter, obscuring continued improvements in sales-out to our solution and reseller partners. Supply chain and logistics remained a bright spot in the quarter, with revenue increasing sequentially, primarily from us shipping additional gateways to the North American supply-chain and logistics end user we discussed on prior calls. We do not expect shipments to that end user in the fourth quarter. We also generated modest third-quarter revenue from shipments of our Impinj R700 readers into our second large North American supply chain and logistics end user and we anticipate modest revenue from that end user again in the fourth quarter. That opportunity, as we said last quarter, is large, but the deployment timing and pace remain uncertain. Looking to the fourth quarter, systems revenue will remain constrained as we balance puts from improving demand and the second North American supply chain and logistics end user beginning its ramp against takes from ongoing channel-inventory reductions and the first large North American supply chain and logistics end user continuing its transition to an operational phase. With our recent announcement of R700 general availability and the new opportunities the R700's enterprise-class capabilities open in the supply chain, we remain excited about our systems prospects ahead.

Covid-19 has fundamentally altered end-user business operations, suppressing demand for fixed readers in the near term but, we believe, engendering a demand rebound when those businesses have clarity to Covid-19's end. In some verticals we already see green shoots of recovery.

Looking first at retail, with foot traffic down, retailers in the near term are focused on the imperative for omnichannel fulfillment, using mostly labor-intensive but quick-to-deploy handheld readers. Consequently, we see growing fourth-quarter demand for endpoint ICs and, to a lesser extent, for reader ICs, the latter because retailers have fewer fulfillment centers than they do stores. Our pipeline of retail fixed-reading opportunities remains strong, especially in loss prevention and self-checkout, but omnichannel investments remain paramount. We also now see retailers driving two distinct go-forward paths to RAIN-based loss prevention and self-checkout. One is entirely RAIN based and uses RAIN-enabled exit gates, RAIN tags and RAIN self-checkout terminals. The other combines RAIN and traditional RF EAS. This combination allows retailers to use their legacy EAS exit gates with merged RAIN and RF-EAS tags and RAIN self-checkout terminals. The former requires more readers and gateways whereas the latter promises quicker deployments. Both afford significant opportunities for us.

In supply chain and logistics, we also see traction in two go-forward paths. One path focuses on identifying tagged pallets transitioning through dock doors. The other focuses on identifying tagged cartons on conveyor belts. The former drives gateway sales and pallet tags; the latter drives reader sales and carton tags. Both are in our platform's sweet spot, and both leverage our experience from our North American end-user deployments. Like for retail, here again we have a strong pipeline, but deployments have been slowed by Covid-19 impacting our partners' installation teams, end users pacing reader installations when they are operating at peak volumes, or both. Regardless, with our first large deployment transitioning to its operational phase and a second large deployment just starting, we are only scratching the surface of the total supply-chain and logistics opportunity.

In closing, revenue rebounded in the third quarter, with underlying strength in our core markets, but the effects of Covid-19 remain. Regardless, we remain focused on exiting the other side of Covid-19 a stronger company in a stronger market position than when we entered it. We also remain focused on the big picture, on the strong underlying secular trends evidenced by our business strength prior to Covid-19, and on our opportunity to use RAIN to deliver the digital transformation our end users want and need. With a strong balance sheet, game-changing new products and a platform and vision that sit squarely in the center of that digital transformation, the opportunity in front of us is more compelling than ever. We will continue focusing on leading apparel retailers and on leading supply-chain and logistics companies, driving operational improvements for them and business opportunities for us. We will do so even as we keep a close eye on expenses, charting 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 fourth-quarter outlook. Cary.

Cary Baker, Impinj Chief Financial Officer

Thank you Chris, and good afternoon everyone.

Today, I will cover the metrics we typically discuss on our earnings calls and provide a financial outlook for the current quarter.

Third-quarter revenue was $28.2 million, declining 30.8% year-over-year and increasing 6.6% quarter-over-quarter, compared with $40.8 million in third-quarter 2019 and $26.5 million in second-quarter 2020.

Third-quarter endpoint IC revenue was $21.6 million, declining 18.1% year-over-year and increasing 16.4% quarter-over-quarter, compared with $26.4 million in third-quarter 2019 and $18.5 million in second-quarter 2020. The recovering retail demand environment drove a favorable dynamic in third quarter, with our inlay partners reducing the inventory they built in first-quarter 2020 and turns orders returning in the latter half of the third quarter. While our third-quarter revenue declined year-over-year, in part due to that channel inventory reduction at our inlay partners, we believe our year-to-date revenue growth now reflects our 2020 demand environment. Looking ahead, while fourth-quarter endpoint IC revenue is typically lower sequentially, fourth-quarter 2020 will benefit from a comparison against third-quarter 2020 where inlay partners were reducing inventory. Generally, we expect 2020 endpoint IC revenue on par with 2019.

Third-quarter systems revenue was $6.6 million, declining 54.1% year-over-year against a difficult third-quarter 2019 comparison of $14.4 million, and declining 16.5% quarter-over-quarter, compared with $7.9 million in second-quarter 2020. Gateway revenue declined year-over-year but grew quarter-over-quarter, as the large North American project continued generating modest revenue in the third quarter. Reader revenue declined year-over-year and quarter-over quarter, impacted by demand, deployment pace and timing and channel-partner inventory dynamics. The second North American supply chain and logistics deployment progressed with modest financial contribution in the quarter. Reader IC revenue declined year-over-year and quarter-over-quarter due to lower demand for handheld readers at retail and a comparison to second-quarter where partner’s built modest inventory to reduce supply risk. We expect fourth-quarter systems revenue to remain constrained as broad-based rebounding demand is offset by channel-partner inventory dynamics and by the North American supply chain and logistics customer moving fully to the operational phase.

Third-quarter gross margin was 50.1%, compared with 50.2% a year ago and 51.4% last quarter. On a year-over-year basis, gross margin declined 10 basis points, driven by revenue mix and leverage on lower revenue partially offset by lower E&O charges. On a quarter-over-quarter basis, gross margin declined 130 basis points, driven by revenue mix partially offset by lower E&O charges.

Total third-quarter operating expense was $20.4 million, compared with $18.4 million in third-quarter 2019 and $18.8 million in second-quarter 2020. Research and development expense was $9.4 million. Sales and marketing expense was $5.4 million. General and administrative expense was $5.5 million.

Third-quarter adjusted EBITDA was a loss of $6.2 million, compared with a profit of $2.1 million in third-quarter 2019 and a loss of $5.2 million in second-quarter 2020.

Third-quarter GAAP net loss was $14.3 million. Third-quarter non-GAAP net loss was $6.7 million, or 29¢ per share, using a weighted-average diluted share count of 22.9 million shares.

Turning to the balance sheet, we ended the third quarter with cash, cash equivalents and short-term investments of $105.1 million, compared with $63.1 million in third-quarter 2019 and $120.9 million in second-quarter 2020. Inventory totaled $38.0 million, up $1.7 million from third-quarter 2019 and increasing $900 thousand from second-quarter 2020.

In the third quarter, net cash used in operating activities was $11.0 million and property and equipment purchases totaled $1.1 million. Free cash flow was negative $12.1 million. We have excluded from third-quarter net cash used in operating activities and free cash flow the $5.4 million cash outflow associated with the settlement of our shareholder class-action lawsuits.

I will now provide an update on a few of our strategic initiatives. First, the capital investment in our 300-millimeter endpoint IC wafer post-processing flow continues. This ROI-driven project spans multiple years and will increase our operations responsiveness, broaden our geographic and partner diversity and improve our inventory turns. Looking ahead, capital expenditure will look more like 2018 versus 2019 or the beginning of 2020. This investment will begin paying dividends in 2022 and, over time, will generate a positive return to shareholders.

Second, we will maintain adequate supply of 200mm endpoint IC wafers as we stage our transition to the 300mm M700 family. That 200mm inventory uses cash in 2020 and will be a source of cash in 2021. In 2021, we expect our days of inventory to improve.

Third, we entered 2020 with ambitious hiring goals to boost our engineering investment and filled most of those open roles by the end of third quarter. As a consequence, we expect an increase in fourth-quarter operating expense and we will grow into that investment in 2021. Looking forward, we will continue to monitor expenses and remain confident in our plan to return to adjusted EBITDA breakeven on the other side of Covid-19.

Turning to our outlook, we expect fourth-quarter revenue to be between $26.5 and $28.5 million, a 32.6% year-over-year decline at the midpoint of the range. We expect adjusted EBITDA to be between a loss of $8.9 million and $7.4 million. On the bottom line, we expect non-GAAP net loss between $9.3 million and $7.8 million, reflecting non-GAAP per-share earnings of between -40¢ and -34¢ on a weighted-average diluted share count of 23.0 to 23.1 million shares.

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

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