Sequans Fourth Quarter and Full Year 2020 Results Call

Operator:

Welcome to the Sequans Fourth Quarter 2020 Results conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a Question and Answer session. Instructions will be given at that time. As a reminder, this conference is being recorded.

Before I turn the conference over to our host, Mr. Georges Karam, I would like to remind you of the following important information in behalf of Sequans.

This call contains projections and other forward-looking statements regarding future events, or our future financial performance and potential financing sources. All statements other than present and historical facts and conditions discussed in this call, including any statements regarding our expected seasonal revenue decline for the fourth quarter of 2021, long-term revenue goals, future results of operations and financial positions, business strategy and plans, expectations for Massive IoT and Broadband and Critical IoT sales, the ability to continue to operate remotely (as required) at high levels of productivity, increasing backlog of orders, the impact of the coronavirus on our manufacturing operations, supply chain, and on customer demand, the impact of component shortages and our manufacturing capacity, and our objectives for future operations, are forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended). These statements are only predictions and reflect our current beliefs and expectations with respect to future events and are based on assumptions and subject to risk and uncertainties and subject to change at any time. We operate in a very competitive and rapidly changing environment. New risks emerge from time to time. Given these risks and uncertainties, you should not rely on or place undue reliance on these forward-looking statements. Actual events or results may differ materially from those contained in the projections or forward-looking statements. More information on factors that could affect our business and financial results are included in our public filings made with the Securities and Exchange Commission.

Thank you.

Please go ahead, sir.

Georges:

Good morning, ladies and gentlemen. This is Georges Karam speaking. I am with Deborah Choate, our chief financial officer. Welcome to our fourth quarter and full year 2020 results conference call.

We hope everyone is remaining healthy. Our global organization continues to take the necessary steps according to local conditions to ensure the safety of all our people and we continue to function very well.

As you have seen by our press release, we exceeded our revenue target in Q4, even as demand related to portable routers had begun to return to pre-COVID levels, leading to full year revenue growth of 65% compared to 2019. This is a very good start toward our goal of an average of 50% annual growth for the 2020-2024 period. As we indicated during our investor event a month ago, we are expecting our served market to grow a little above 40% a year, on average, through 2025. We set our five-year target for average annual growth above the expected market growth rate because we believe that we will be in a strong position to gain market share with our second-generation Massive IoT products and, later, with our high-end 5G NR Taurus platform.

The remainder of our results for the fourth quarter and full year were in line with, or better than, our expectations and .... we've strengthened our balance sheet as well. Deborah will give you all the specific financial details. I will focus here on the business aspect and share with you what we think is significant from this perspective, then highlight some key accomplishments and exciting new developments.

In 2020, I'm pleased to say we grew in each major category. Massive IoT grew 8%, with the impact of COVID on the automotive-related business

and the timing of some projects partially offset by stronger demand from e-health customers. Broadband IoT grew 145%, mainly due to the huge demand generated by initiatives with schools related to supplying portable routers for distance learning. By year end, the portable router-related demand had already begun to return to pre-COVID levels, with some excess inventory at the operator. The Vertical category grew over 50%. Note that this vertical category includes the revenue contributed by our major strategic deal with the Fortune Global 500 company for 3+ years signed in Q4 of 2019.

In 2021, the reduction in demand for portable routers should be more than offset by the acceleration in the ramp in demand for Massive IoT, especially relative to last year, and we expect this category to be the primary driver of growth for Sequans in 2021. New CBRS business and more revenue from emerging markets within the Broadband category will also help to compensate for the absence of a surge in portable router-related business . . . and the Vertical category will also grow year-over-year, with higher revenue contribution from the large strategic deal and new deals we expect to close.

Gross margin for both products and services improved in 2020. Meanwhile, our operating expenses reflected a headcount increase necessary to support our 5G development. Given the higher-than-expected revenue and gross margin, our net loss was less than expected in 2020 . . . and, after adjusting for all the non-cash accounting items and foreign exchange differences, we had a smaller loss than in 2019. So, it was a year to be proud of from the execution standpoint.

2020 was also an excellent year from the sales and business development perspective. We ended the year with a large pipe of design wins and

advanced opportunities and we closed 2020 with the highest-ever level of booking, a strong indication that momentum is building. And since the end of the year, we secured multiple additional design wins. I will speak more about those in a moment.

Some other important accomplishments in 2020 that are not captured by the financial statements included:

- We made an important step in sustaining our technology leadership in Massive IoT by introducing the second generation of our Monarch platform optimized for LTE-M/NB-IoT, which has been sampling since the beginning of 2020. In Q4, we introduced a module based on Monarch 2. As we noted during our January investor event, the customer reception has been excellent, largely because we have built on the maturity of Monarch 1 and its reputation, adding advanced features and significantly reducing power consumption. During the event, we spent considerable time discussing the major opportunities we see in metering. We also discussed our relationship with Itron, the largest company in the metering space, so I won't repeat it all here except to note that, in Q4 and so far in Q1 we have landed many new designs wins in the metering space as well as other Massive IoT applications.
- Meanwhile, during 2020 we also announced our second-generation Calliope platform for Cat 1, which will be sampling in the first half of this year. As mentioned during the investor event, this is a unique offering with huge potential, and we expect Calliope 2 to drive market share gains in the Cat 1 portion of the market beginning next year. During Q4, we secured a proof-of-concept phase of a project with a large consumer electronics company for a product using Calliope 2

and extended our Renesas engagement in Massive IoT to cover Cat1 in addition to LTE-M/NB-IoT. Then, in January, we were very pleased to announce that Thales/Gemalto will adopt both Monarch 2 and Calliope 2 as the basis for its new LTE-M and Cat 1 modules for Massive IoT. It is always confirmation of our performance and leadership and gratifying to win a repeat customer – in this case for the third time. There is also strong interest in Calliope 2 from other module-makers as well... and we have recently engaged with a major OEM. Meanwhile, we are pleased that we are seeing strong demand for our current Cat 1 platform – much stronger than we expected – from existing customers.

- On top of our work on second-generation Massive IoT products, we also managed to reach all our major 5G milestones on schedule and the relationship with our major 5G strategic partner is progressing very well. As announced last month, in addition to Monarch 2 and Calliope 2, Renesas has chosen to work with us on Taurus, our high-end 5G/4G platform. We are seeing very strong interest in Taurus from both potential strategic partners and potential alpha customers. We expect this interest to increase as we get closer to sampling because everyone is looking for a more fully-optimized and cost-effective solution for Broadband and Critical IoT applications than is currently available in the market with existing solutions that are optimized for smartphones.
- Finally, during 2020, we implemented very important go-to-market initiatives designed to scale our direct sales capability with the addition of several reps . . . and to scale our channel capabilities with the addition of several large distributors and several microcontroller companies as partners. All of these have already born fruit in the form

of design wins or significant new business opportunities . . . and we expect even more traction as time goes on. Expanding our reach and positioning the company to serve a fragmented market through these distributors and channel partners will be a key factor in our ability to reach scale.

The important take-away from this summary is: all these accomplishments will lead to business that will turn to revenue in future periods.

During our virtual event last month, we also shared a snapshot of our pipeline of potential business -- $500 million in product revenue, assuming a 3-year revenue cycle from the date the customer's device goes into initial production. Also, we have indicated that we have another $100 million in potential services revenue that we track separately because it tends to convert to revenue a bit differently than products. Over this pipe of opportunity, we indicated at the event that 40% of the product pipeline has been secured by design wins and will turn to revenue. The percent of potential services revenue secured by design wins is a little higher than 40%. Today, we are very excited to highlight further design-win progress since the beginning of the year:

Massive IoT

We announced a design win with WiThings in January. This well-known company is a spin-off of Nokia that provides smart health devices. We are pleased to report that we have already received our first order. E-health is an important market within Massive IoT and we have a great traction there with many advanced opportunities. Specifically, we are finalizing and are about to kick off two projects with the healthcare division of a major

conglomerate. Meanwhile, our existing E-health business, driven mainly by the infectious disease testing application, continues to have strong demand.

We continue to enjoy success in the metering market. We have secured the second phase of deployment with Tepco in Japan. We are working to launch the first Itron project and one with a new metering customer we secured in Q4. Since our virtual investor event, we have landed another major metering design win. Plus, we have strong interest and on-going discussions with two new big deals. So we believe metering is going to be a source of strong growth for the company.

In the smart home and security space, we have recently secured two new design wins, both using our Monarch 2 platform. Product development has started and they are targeting a launch in Q4 this year.

In the wearables/hearables area served by Cat 1, we have a major design win in Europe scheduled to begin initial shipment this quarter. Also, we expect to move the design win we have in the US from the proof-of-concept phase to the full launch phase with the arrival of Calliope 2. Engagements on Calliope 2 will be developing through the year and we feel very confident that we can end this year with multiple design wins in this space, specifically through the partnership of Thales/Gemalto and Renesas.

In tracking and monitoring, we recently secured several smaller deals and we are working to close some larger ones as well.

In January, we also announced a demo of a joint solution with e-peas, a pioneer in energy harvesting, a technology that would enable IoT devices to run without batteries. While we are far away from generating revenue

from a joint solution, collaborating with this type of company shows our commitment to remain at the cutting edge of technology and also demonstrates our commitment to sustainability and a better environment.

In summary, we are entering 2021 with a strong feeling about the ramp of Massive IoT and we see our business developing in the following four markets: tracking and fleet management, medical and well-being, security and smart home, and metering followed quickly by wearables/hearables as a fifth market segment. And we believe, most of this business is very "sticky" and will deploy over six or seven years, if not more.

Broadband and Critical IoT

We are seeing CBRS beginning to generate revenue and we expect this ramp to accelerate during the second half of this year. Last week we announced two design wins with AMIT Wireless to facilitate distance learning using CBRS private networks. As we've mentioned previously, we have more than a dozen customers, including Telit as a module partner, intending to serve private networks for factories, utilities, campuses, stadia, and transportation hubs such as airports and train stations. Over time, we think the CBRS market has very good potential, particularly since we are beginning to see some mobile computing applications for tablets and MiFi devices to repeat what we said a month ago.

We are gaining traction in emerging markets as expected. Our business from emerging markets doubled in 2020 from a very low base in 2019. We see the potential for it to double again in 2021 and make a more significant contribution to Broadband revenue.

We are working to close a couple of sizeable new projects for our Cat 4/Cat 6 products with existing customers in the U.S., and we are engaged with a few others in Europe as well.

We continue to expect the JetPack demand to be at pre-COVID levels during 2021 and, in the very short term, there is also some excess inventory they will need to work down. We saw some impact from this in Q4, as JetPack-related revenue declined from the peak of Q3. We never expected JetPack demand to remain at COVID-surge levels, therefore, all our previously-communicated long-term growth targets have assumed that the primary demand driver in 2021 would be Massive IoT and that Broadband IoT would be, best case, flat versus 2020, but more likely somewhat lower because the growth in CBRS and emerging markets may not be enough to completely offset the decline in portable router-related business. For this reason, we are especially pleased by the recent good news I just discussed within Massive IoT because it gives us additional confidence that demand from Massive IoT will more than compensate for lack of growth in Broadband IoT as a whole.

On the Broadband 5G front, we are making very good progress on our 5G Taurus Platform development. The major strategic deal we have with our Fortune Global 500 partner is on track since Q4 2019, and we to expect to recognize more revenue in 2021 than we did in 2020. Note that we track this revenue in the Vertical category because the services project is so large, it would distort the broadband category from quarter to quarter and the Vertical category is typically lumpy anyway. Once we start to have product revenue from this customer, it will be counted in the Broadband category as 5G product.

Also, as mentioned earlier, in Q4 Renesas became a module partner for 5G, in a deal of around $5 million, with revenue to be recognized over 2021 and 2022. This new deal expands our go-to-market partnership from Massive IoT to cover also 5G Broadband IoT.

Finally, we recently announced that we were chosen to lead a consortium of seven French companies in one of only four projects awarded by the French government to support technologies it deemed strategic for the national interest. This award comes with funding in the form of a grant of approximately $6.7 million. The work of the consortium will be aimed at securing national sourcing for strategic technology for critical industrial, medical and scientific markets and delivering end-to-end 5G solutions for public and private networks, with particular focus on the enterprise market.

From the strategic perspective, the partnerships, the companies interested in being 5G alpha customers, the government grant . . . all these illustrate a point we've been making – which is the scarce resource we represent, particularly when it comes to 5G. It appears this scarcity factor is beginning to be recognized in our valuation.

Vertical

There is a lot of traction in the satellite and public safety and military spaces, where customers are relying on our ability to modify the software of our 4G and 5G platforms to fit with the requirements of such applications. Hence, we continue to be confident that 2021 will show higher revenue in the vertical category. As I just mentioned, we count services revenue recognized from our large 5G strategic deal in this category and this will grow in 2021. In addition, our confidence is growing that our vertical market customer in the satellite space will be successful in

winning the large project which has been awaiting a formal decision for some time now. The decision is expected any day now and we hope it will come in time to finalize the deal and recognize some initial revenue in Q1.

We have active discussions on additional vertical deals, where we are optimistic because they are extending our work with satisfied existing customers and some are with potential new customers.

To recap all these positive developments, we not only have a backlog that is the strongest we've seen, but we have new design wins that could move fast enough to contribute to revenue this year and will certainly contribute to next year and beyond, plus new strategic projects that will help fuel the next wave of growth related to 5G. We expect this will constitute enough demand to achieve 2021 revenue consistent with our long-term growth objective.

To elaborate on our growth objectives, we believe our company can be 50%-per-year grower for at least 5 years – not necessarily *every* year, but on average as an order-of-magnitude indication of what we think our business can deliver. In 2020 we grew above the trend line with almost 65% growth. We are not particularly concerned about whether our revenue in a given period is slightly above or below the trend line since timing of revenue recognition can be a major factor, in addition to demand. We now have a line-of-sight that says we should expect to exceed $100 million in revenue next year and to reach scale on a quarterly basis the year after. With a whole new growth engine represented by our 5G Taurus platform beginning to contribute in 2023, we can realistically expect to reach scale for the full year in 2024 with revenue over $200 million. This is the growth trajectory we keep in our sights, not the quarter-to-quarter fluctuations due to seasonality or timing factors.

So, given our backlog and strong design win momentum, we are comfortable with the range of analysts' estimates for this year strictly from the perspective of demand.

However, like the rest of the industry, we are facing sourcing challenges in the form of a global shortage of some assembly material like PCB and substrate and silicon capacity constraints at TSMC. We are working on various initiatives to mitigate the bottlenecks in our supply chain, but meanwhile there is a risk that some shipments could be delayed. Since the entire industry is in the same boat, we don't expect this to result in loss of business – only potential delays.

As we work on mitigation plans for the near-term sourcing issues, we continue to develop greater confidence in our long-term growth as we secure more business via design wins and identify new opportunities and gain more interest from our 5G platform to help fuel our growth beyond the next two years.

I'll now turn the call over to Deborah.

Deborah:

I'd like to add some details about our Q4 and full year 2020 results and other developments.

Our revenue for the full year was $50.9 million, an increase of 65.0% versus 2019, substantially exceeding our goal of 50% year-over-year growth.

Revenue increased in all categories in 2020 compared to 2019. Broadband IoT accounted for about 50% of total revenue in 2020, primarily due to the surge in demand related to portable routers to support students learning from home. Both Cat 1 and Cat M revenue increased in 2020, and Massive IoT accounted for about 30% of total revenue. The Vertical category, which includes service revenue generated by our major 5G strategic deal, increased in 2020 compared to 2019 as well.

Gross margin in 2020 increased to 46.1% from 40.1% in 2019. Product gross margin was 32.4% compared to 23.9% in 2019, even with a high proportion of modules in the mix.

The increase in operating expenses occurred mainly in R&D and resulted primarily from an increase in headcount and related recruiting fees.

Financial expenses were higher than 2019 due to higher interest expense, mainly the result of nearly a full year of interest on the convertible debt issued in 2019, the change in the fair value of the embedded derivative in convertible debt – which represented alone a non-cash loss of $13.1 million, plus a less favorable foreign exchange rate causing foreign exchange losses.

As a result, our IFRS net loss increased to $54.5 million, or ($1.94) per diluted ADS, compared to $36.7 million or ($1.54) per ADS in 2019.

On a non-IFRS basis, our net loss for 2020 increased to $33.0 million, or ($1.17) per ADS, compared to $31.6 million, or ($1.33) per ADS, in 2019. Our non-IFRS net loss excludes non-cash items related to stock-based compensation expense, and the non-cash impact of the fair-value and effective interest adjustments related to the convertible debt with embedded derivatives and other financings, the non-cash impact of convertible debt amendments, and the non-cash deferred tax benefit or expense related to the convertible debt and other financings.

Adjusting for the foreign exchange loss in 2020 and a gain in 2019, our non-IFRS loss in 2020 declined year-to-year and was a better result than most analysts' expectations. Neither we nor the analysts attempt to forecast changes in foreign exchange rates.

Q4 2020

Turning to the results of Q4, our revenue was $15.8 million, a sequential increase of 11.8% from the third quarter, which was above our target of at least 10% growth. Revenue in Q4 increased 58.4% compared to the same quarter a year ago.

We again had three greater-than-10% customers in the fourth quarter: one is an OEM and two are ODMs.

Gross margin in Q4 was 45.1% compared to 42% in the third quarter, and compared to 51.2% in the fourth quarter of 2019 when there was a higher proportion of license and service revenue in the mix. The Q4 2020 gross margin reflects a higher proportion of chips in the product mix than in Q3, as well as a higher proportion of service revenue.

IFRS operating expenses were $12.5 million in Q4, up from $11.8 million in Q3, primarily due to higher non-cash stock compensation expense, fees related to convertible debt conversion and an unfavorable euro/dollar exchange rate compared to Q3. Non-IFRS operating expenses were $11.4 million, basically flat compared with $11.3 million in Q3.

Our fourth quarter operating loss was $5.4 million, compared to an operating loss of $5.9 million in the third quarter, and a $4.6 million loss in the fourth quarter of 2019.

Our net loss in Q4 was $11.3 million, or ($0.36) per diluted ADS, and included a non-cash gain of $111,000 from the revaluation of the embedded derivative arising from the March 2020 amendments to the convertible debt agreements. This compares to a net loss of $9.0 million, or ($0.30) per diluted ADS in the third quarter, which included a non-cash gain on the revaluation of the embedded derivative of $1.5 million. The net loss in the fourth quarter of last year was $8.1 million or ($0.34) per ADS.

On a non-IFRS basis, our net loss for Q4 was $8.5 million, or ($0.28) per diluted ADS, compared to a non-IFRS net loss of $8.4 million, or ($0.28) in the third quarter, and net loss of $6.8 million or ($0.29) per diluted ADS in the fourth quarter of 2019.

In Q4 we had a foreign exchange loss of almost $1.9 million (or $0.06 per ADS), most of which was unrealized and non-cash, related to the revaluation of Euro-denominated liabilities on the balance sheet. Adjusting for the foreign exchange loss, our non-IFRS net loss was lower than expected.

Investors should be aware that possible changes in foreign exchange rates related to balance sheet items and the marking to market of the embedded

derivative from the convertible debt amendments can cause significant differences in net income or loss from quarter to quarter. While the impact of swings in the value of the embedded derivative is excluded from our non-IFRS presentation, foreign exchange gains and losses, whether realized or unrealized, are not.

Cash flow used in operations during Q4 was $1.4 million, compared to $7.9 million in the third quarter. Our cash and short-term deposits at December 31, 2020 totaled $18.5 million, compared to $25.3 million at the end of Q3.

As noted during our investor event, we expect to receive a substantial portion of the $5 million strategic deal with Renesas as an upfront payment in Q1. Also, if the final decision on the vertical deal – the satellite project – is made soon, we could also expect to receive a substantial upfront payment during Q1 or early Q2. The cash related to the grant from the French government will be paid over 3 milestones with the first one upfront, expected late Q1 or early Q2. Considering that we have more strategic deals that would likely have some upfront payment as part of the terms and more vertical deals that could provide additional cushion, we are feeling good about our cash situation.

Turning to some other balance sheet items, accounts receivable at December 31, 2020, increased to $17.3 million from $14.2 million at the end of Q3, primarily reflecting invoices related to the new strategic project with Renesas. DSOs were 73 days compared to 91 days at the end of Q3 after excluding the impact of this new strategic project which distorts the picture.

Inventories increased to $6.2 million compared to $5.8 million at the end of Q3 due to product revenue growth.

Current trade payables decreased to $15.7 million versus $17.2 million at the end of Q3.

Short-term debt from financing receivables decreased slightly to $14.2 million from $14.4 million at the end of Q3.

Our convertible debt, which is all classified as long-term, decreased to $26.1 million reflecting the conversion of $12.4 million in principal and accrued paid-in-kind interest in Q4.

In January, Nokomis converted an additional $5.5 million in principal and accrued interest related to the notes issued in 2015.

As Georges explained, we entered this year with our highest-ever level order book and we are expecting strong overall demand to continue. Q1 tends to be seasonally lower than Q4 even in a “normal” year, and we would expect to see the same pattern this year. However, we are not giving specific quarterly revenue guidance or a revenue target for 2021 at this time due to the lack of visibility regarding the impact of various bottlenecks in the supply chain, which could delay some shipments and related revenue. Excluding the potential for some ongoing impact of the industry-wide sourcing challenges, we would expect to grow revenue sequentially in Q2 and throughout the remainder of the year.

For those of you developing financial models, you can make your own top line assumptions, but to help with your modeling, we’ll share some margin and opex assumptions based on an assumed revenue level similar to the average of analysts’ current revenue estimates, which is $71 million for 2021. On this basis, we assume non-IFRS gross margin in 2021 will average about 48% for the year based on the assumed mix.

Non-IFRS operating expenses are expected to average $11 million to $11.5 million per quarter in 2021, as we begin to capitalize 5G R&D expense in Q1, assuming a stable euro/dollar exchange rate.

We expect non-IFRS financial expenses to be around $1.3 million per quarter in 2021, excluding any foreign exchange gain or loss. As much of the interest expense is non-cash PIK, we expect to pay out in cash only about $600,000 per quarter.

Finally, for modeling purposes, the exact number of ADSs on January 31, 2021 was 34,362,055.

Before I turn the call back to Georges, I'd just like to remind you that at the conclusion of this call, we will post a written version of our formal remarks in the Investor Relations section of our website on the "Webcasts and Presentations" page . . . the same location where you will find the audio replay.

Also, Georges and I will be participating in the virtual Roth Conference in min-March. We look forward to speaking with you if you plan to participate.

Now I'll turn the call back to Georges . . .