Sequans First Quarter 2022 Earnings Conference Call

Operator:

Welcome to the Sequans First Quarter 2022 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.

I would now like to turn the call over to Kim Rogers of Hayden IR. Ms. Rogers, you may begin.

Thank you, [name],

And thank you to everyone participating in today's call. Joining me on the call today from Sequans Communications are Georges Karam, Chairman, and Chief Executive Officer, and Deborah Choate, Chief Financial Officer. Before turning the call over to Georges, I would like to remind our participants of the following important information on behalf of Sequans.

Sequans issued the earnings press release this morning, which was posted to the Company's website at www.sequans.com under the "Newsroom" section.

Before we start, I would like to remind everyone that this conference 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 contained in this call, including any statements regarding future results of operations and financial positions, business strategy and plans, including financing alternatives for our 5G business, expectations for Massive IoT and portable router sales, the impact of the Covid-19 on our supply chain and on customer demand, the impact of component shortages and manufacturing capacity, our ability to convert our pipeline to revenue 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.

And now, I would like to hand the call over to Georges Karam. Please go ahead, Georges.

Georges:

Thank you, Kim. Good morning, ladies and gentlemen. Welcome to our first quarter 2022 financial results conference call.

Sequans is off to a strong start in 2022. First quarter revenue grew by more than 12% year-over-year and, when adjusted to exclude the $1.1 million of the Verizon Jetpack contribution from the first quarter 2021, revenue grew by 23.7% year-over-year. The main revenue growth driver was our LTE-M/NB-IoT business with our Monarch products family, which grew more than 24% sequentially and 125% year-over-year, driven by design wins moving into mass production. Also, the Broadband category grew 35% year-over-year, attributable to increased services and licensing revenue from our existing 5G agreements with our strategic partner and Renesas. This increase in service and licensing revenue significantly boosted our gross margin in the first quarter to 68.1%, from 50.1% in the same quarter last year and 57.1% in the prior quarter. The increased margin contribution narrowed our operating loss and reduced our non-IFRS net loss to $1.8 million from a non-IFRS net loss of $5.1 million in the first quarter of 2021.

Massive IoT, and specifically the Monarch LTE-M products family, remains the primary near-term growth lever for Sequans. Our product revenue pipeline now exceeds $320 million of design wins with over 80% for Massive IoT applications. Keep in mind that our pipeline represents expected revenue contribution over three years of design life, with several large projects having longer lifetime spans, in some cases up to ten years, which is not reflected in our pipeline number.

In March, we completed a $20.9 million equity raise, which improved our balance sheet and enhanced our position for negotiating a new 5G strategic agreement.

Let me start by providing an update on the 5G strategic initiative we launched late last year and referenced on our last call

We successfully executed an MOU with a new strategic partner that, once finalized, is expected to fully fund the balance of our 5G investment in the Taurus platform. Due diligence has been completed, and the definitive agreement is currently being finalized with the goal of closing by June 30th.

In parallel with this new strategic partnership, our strong position in 5G has led to other additional non-exclusive, high-potential strategic discussions. These are opportunities that would further expand our addressable market by increasing penetration in existing markets or providing access to new ones that we do not currently serve. We expect to have further clarity on these initiatives over the course of the year.

Switching now to our Massive IoT and Broadband Categories

Typically, we see seasonality in our first quarter product revenue, and that was the case with all our product categories this quarter except for our LTE-M/NB-IoT category that helped to compensate for such effect and allow us to deliver over 12% sequential growth in terms of total number of units (all categories) shipped in the quarter. Massive IoT revenue represented around 45% of our total revenue in the first quarter. The varied performance and ASP of the Cat 1 and Cat M/NB categories of the Massive IoT resulted in flat revenue sequentially. As I stated in my opening comments, the LTE-M/NB-IoT category once again delivered strong revenue growth both sequentially and year-over-year, reflecting the layering in of a number of new design wins that moved into the mass production and shipment phase in the quarter.

The growth in Cat M/NB offsets the contraction in the Cat 1 category, related to lower sales to an eHealth customer, which saw shipments spike last year in the first quarter related to COVID, and the build-up of inventory levels by another customer in 2021 that affected the sequential growth in Q1 2022. That said, Calliope Cat 1 demand remains solid. We expect this platform to return to growth over the balance of the year, with growth accelerating in 2023 driven by the ramp of our second-generation platform, Calliope 2.

On our last earnings call, I outlined our prospects in several Massive IoT markets – three large segments – Smart City / Metering, Asset & Car Tracking, Smart Home and Security – and two smaller segments – Medical & Fitness and People. In each of these growing markets, Sequans is well-positioned to expand, and in some cases, double our market share with both our Massive IoT platforms in Cat M and Cat 1 products. During Q1, we made measurable progress towards this goal by adding design wins in metering, the largest segment, with more projects moving to mass production.

We are one of the few pure plays in Cellular IoT in terms of the breadth and depth of our portfolio with all the advantages of our solution in terms of power, cost, security, and category coverage, and are now partnered with leading MCU vendors. Thus, we anticipate increasing our share to 30% of our addressable market on average in each of these segments as they expand. Put another way, we believe that our growth rate in the Cellular IoT can exceed the 40% five-year CAGR forecasted for the industry.

Our Broadband category showed modest sequential growth this quarter and increased by 35% year-over-year. When adjusted for the Jetpack revenue in the first quarter of 2021, annual growth for Broadband rose by 66%. The significant growth in services and licensing revenue offsets the seasonal decline in product revenue we typically experience in this category in the first quarter.

In CBRS, we are experiencing a delay on one big project and the demand on other CBRS projects is lumpy, with the private networks market still developing. As a result, CBRS revenue will be muted in the first half of 2022, but we expect this business to pick up in the second half of the year. Although flat, the Cat 4/Cat 6 emerging market business remains productive. While our differentiated CBRS offering helped us re-establish our Broadband IoT business, our focus for this category remains on private networks applications where we are progressing on a key strategic initiative creating new design opportunities that we could secure this year. We will talk more about this initiative in the near future as it could boost our revenue growth in the legacy Cat 4/Cat 6 business.

The new 5G Taurus platform is the major long-term growth driver of our Broadband IoT business. We are addressing a significant opportunity potentially exceeding $2B by 2025 that could triple our addressable market. The 5G Taurus platform development, which is the largest segment of our R&D spending, is progressing at full speed. We expect to have our RF chip back for testing by the end of May and we are on track with the development of the other Taurus platform components. Our goal is to begin full product sampling in 2023. Given the progress we are achieving with strategic partners, we are highly optimistic about the next major growth lever for Sequans, our cellular IoT 5G product line.

Looking at our backlog and pipeline

We entered 2022 with a record backlog of non-cancelable orders that continued to grow in Q1. Also, our business pipeline keeps building with new design wins and new opportunities. It is now well above $650 million of three-year product revenue, with around 50% in the design win stage. Over 80% of our design wins are for Massive IoT applications, predominantly for the Monarch 2 Cat M platform. The broad success of our second-generation Monarch 2 platform has been a significant driver of pipeline growth, along with Renesas' LTE-M/NB-IoT module product line. We continue to expand our pipeline in metering and expect to see a continuous inflow of new engagements in this large growth sector. We added three new metering design wins in the first quarter, two of which are with new customers.

Our existing Cat 1 business is very solid with a strong backlog, and our next-generation Cat 1 Calliope 2 platform continues to receive substantial interest, as evidenced by the successful launch of Calliope 2. The positive market reception and ongoing interest are creating a strong revenue pipeline for Calliope 2. We expect to close several new deals in the near future as we turn to mass production on this product. Given the reception, we are confident that Cat 1 Calliope 2 will be a new growth lever in 2023.

If we analyze our pipeline, we still have a majority of the design win projects in the development phase with modest revenue contribution. Many of these are anticipated to move into mass production later in 2022. We have three significant projects potentially having an annual run rate of over one million units each. This quarter, we began shipping one of them and have secured a backlog for the second one that will move to production in Q3. However, some of the design win projects are moving into mass production slower than had been initially planned due to supply chain issues our customers are experiencing and other execution challenges they are facing. This may affect our 2022 growth target for Massive IoT as some shipments could push into late 2022 or early next year. These possible delays are not expected to impact our 2023 revenue growth forecast.

Overall, our backlog continues to grow, and our potential sources for future revenue streams continue to expand. This is expected to accelerate further once Calliope 2 starts to add to our pipeline. As more projects progress toward mass production, we will see an expansion in our

revenue even if some external variables could affect the timing ramp of certain projects in 2022.

Our MCU partnerships bring considerable value

Our MCU partners considerably strengthen our go-to-market strategy, and they value Sequans' contribution to their offerings. Sequans brings cellular technology to each of them who need this expertise to have a competitive, comprehensive IoT solution. Each partner has its unique strategy for working with us, which removes the need for exclusivity in our agreements. This broadens our addressable scope, giving us access to opportunities we would not have otherwise.

The expanded partnership with Renesas has been successful on both the business development side, as evidenced by the growth in revenue pipeline, as well as on the second sourcing of manufacturing options to solidify our supply capability. Our other MCU partnerships continue to be valuable to Sequans as well, and we have numerous exciting projects under discussion with them, with design wins in the pipeline. Yesterday Microchip launched a tiny Cellular IoT platform, Arduino compatible, integrating our Monarch 2-based GM02S module with the Microchip AVR MCU. The platform will be distributed via Microchip's extensive distribution network and, as a result, could further expand our design pipeline.

Let me provide a quick update on our supply chain

We are closely monitoring potential business hurdles for the remainder of 2022, including the recent lockdowns in China, the upsurge in the Russia-Ukraine war, and our wafer supply from TSMC. Regarding the lockdown in China, we have managed to limit the impact on our shipment in Q1. That said, we continue to monitor this closely, as this could impact the delivery of modules in Q2 and affect our customers manufacturing devices in China. In terms of our small R&D team located in Ukraine, they continue to work and successfully meet their deliverables. The impact of the Ukrainian crisis on our execution was minimal. Lastly, with the help of TSMC, we have sufficient wafers supply to meet our customers' demand for 2022. Sequans has a close working relationship with the team at TSMC, who supports our goals and our cellular IoT strategy.

In summary, Q1 was strong with growth in Monarch LTE-M/NB-IoT and high interest in Calliope 2, both of which remain important sources of future product growth. We have some fluidity in the timing of a few projects moving to mass production later this year, but we remain on track to deliver nice growth in 2022. Our 5G services and licensing delivered strong growth in the quarter and helped narrow our operating loss.

With the new 5G Strategic engagement expected to progress to closing in Q2, we should have the vast majority of the funding for the remaining development of our Taurus 5G platform, a key long-term growth lever for Sequans. This agreement would also bring high-margin revenue for the next few years, which will improve our financial performance and strengthen our balance sheet.

Today, with a growing pipeline and the new 5G strategic deal under discussion, we have increased confidence that we can deliver sustained long-term growth. Sequans is in an excellent position to expand market share, grow revenue, and improve profitability. I'd like to thank all our shareholders for their ongoing commitment to Sequans. And I'd like to thank my global team for their hard work and dedication.

I'll now turn the call over to Deborah.

Deborah:

Our revenue for the first quarter was $13.9 million, an increase of 12.7% versus Q1 2021 and slightly up compared to $13.8 million in Q4 2021.

- The quarter includes an increase in service and licensing revenue primarily driven by revenue recognition under our 5G deals with Renesas and our existing strategic partner. Product revenue accounted for 43% of total revenue, a 14.4% decrease vs. Q4, reflecting lower product sales of CBRS and Cat 1 modules that have higher ASPs.
- Revenue from Massive IoT in Q1 2022 accounted for approximately 45% of our total revenue with Cat M/NB growth compensating for the lower shipment of Cat 1 modules.
- Revenue from Broadband IoT increased from Q4 2021 as service and licensing revenue generated by our 5G strategic deals increased sequentially and year-over-year. As expected, compared to Q1 2021, product revenue from this portion of our business declined due to the absence of Jetpack sales.

For the quarter, we had three customers that each represented 10% or more of our revenue. One of these is a channel partner with multiple end customers.

Gross margin in Q1 2022 was 68.1%, up from 50.1% in Q1 2021 and up from 57.1% in the prior quarter. The improvement was primarily due to the increase of services and licensing in the 5G Broadband category and, the increase in the product mix of chipset revenue versus module revenue, compared to prior periods.

IFRS operating expenses were $11.4 million, down 4.1% from $11.9 million in Q4 2021 due to a decrease in R&D expense of $264,000 and a decrease in general and administrative expense of $405,000, which was partially offset by an increase in sales and marketing of $179,000. Year-over-year IFRS operating expenses decreased $581,000 compared to $12.0 million in Q1 2021.

Non-IFRS operating expenses, which **exclude stock-based compensation expense,** were $10.1 million in Q1 2022, in line with $10.1 million in Q4 2021.

Our first quarter 2022 operating loss was $2.0 million, an improvement compared to an operating loss of $4.0 million in the fourth quarter of 2021, and a $5.8 million loss in the first quarter of 2021.

We posted net income in Q1 of $2.0 million, or $0.04 per diluted ADS, which **included a non-cash benefit of $6.4 million from the revaluation of the embedded derivatives related to our convertible debt offset partially by $1.2 million of non-cash interest expense**. This compares to a net loss of $7.7 million, or ($0.21) per diluted ADS in Q4, which included non-cash charges of $2.4 million from non-cash interest expense and the revaluation of the embedded derivatives. The net loss in the first quarter of last year was $11.4 million or ($0.33) per diluted ADS, which also included non-cash charges totaling $5.2 million on the revaluation of the embedded derivatives and non-cash interest expense.

On a non-IFRS basis, our net loss for Q1 was $1.8 million, or ($0.04) per diluted ADS, again an improvement compared to a non-IFRS net loss of $3.5 million, or ($0.09) per diluted ADS, in the fourth quarter, and a non-IFRS net loss of $5.1 million, or ($0.15) per diluted ADS, in the first quarter of last year.

In Q1 we had a gain on foreign exchange of $370,000, primarily related to the revaluation of Euro-denominated net liabilities on the balance sheet. This compares to foreign exchange gains of $135,000 in Q4 2021 and $1.4 million in Q1 2021.

Investors should be aware that the company's results are subject to certain market risks, and as a result, our net profit and loss may fluctuate quarter to quarter. Specifically, the financial income (expense) category on the income statement, which is below our operating results, includes foreign exchange gains or losses and the marking to market of the embedded derivatives related to the convertible debt, which can cause significant differences in net income or loss from quarter to quarter. These fluctuations may be more extreme during periods of increased market volatility in foreign exchange rates or in the company's share price. While swings in the value of the embedded derivatives are <u>excluded</u> from our non-IFRS presentation, foreign exchange gains and losses, whether realized or unrealized, are <u>not</u>.

And please remember that our IFRS net loss includes significant non-cash interest expense related to our convertible debt, much of which is excluded in the non-IFRS presentation.

Turning to the balance sheet, cash and short-term deposits totaled $26.3 million at the end of Q1 compared to $4.8 million at the end of 2021. The Q1 2022 closing amount reflects the proceeds from our equity raises during the quarter.

Cash used by operations for the first quarter of 2022 was $2.8 million, an improvement over the $4.7 million used by operations in the fourth quarter of 2021.

Short-term debt from financing receivables increased modestly to $9.7 million versus $9.5 million at the end of Q4.

As Georges mentioned, we successfully executed an MOU with a new 5G strategic partner effective March 31 that, once executed, is expected to fully fund the balance of our 5G investment in the first Taurus platform and minimize its cash burden while reinforcing our balance sheet. Thanks to equity deals completed in Q1, we believe we have sufficient resources to fund our operations even without the new 5G deal, but we would likely invest in our 5G development at a slower rate.

Regarding the outlook for Q2, we are currently targeting sequential growth in the quarter, although we continue to monitor the potential impacts on revenue of China's pandemic lockdowns and of supply chain disruptions on the timing of product shipments and project advancement.

We expect service and licensing revenue to continue to be a large part of the revenue mix in Q2 and therefore, we expect gross margin to be above 55% in the quarter.

We expect that non-IFRS operating expenses, which exclude stock compensation expense and assume a stable euro/dollar exchange rate, will average close to $10.5 million per quarter over the next few quarters.

We expect IFRS interest expense in Q2 2022 to be approximately $2.6 million and non-IFRS interest expense to be around $1.4 million, meaning that we expect our non-IFRS net results to have lower interest expense by $1.2 million. We are not providing guidance on any impact of revaluing the embedded derivative nor possible foreign exchange gains or losses given this is largely determined by market conditions.

Finally, for modeling purposes, the number of ADSs outstanding today is 47.7 million.

We plan to update our outlook once we finalize the strategic 5G agreement as this is expected to have a significant positive impact on our future revenue and gross-margin profile. As Georges mentioned, we are targeting to close and fund by the end of the quarter.

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.

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

Georges:

Thank you, Deborah. Operator, we are now ready to open the call for Q&A…

Post-Q&A comment from Georges:

Thank you again for joining the call today. We look forward to catching up with you during our second quarter 2022 earnings call in August. Please note that we are participating in the B. Riley Institutional Investor Conference on May 26th in Los Angeles, CA.

We look forward to speaking with you soon.