THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

NVEC - Q1 2020 NVE Corp Earnings Call

EVENT DATE/TIME: JULY 17, 2019 / 9:00PM GMT

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Curt A. Reynders *NVE Corporation - CFO, Treasurer & Secretary*

Daniel A. Baker *NVE Corporation - CEO, President & Director*

CONFERENCE CALL PARTICIPANTS

Jeffrey M. K. Bernstein *Cowen Inc. - VP*

Thomas N. Cochran

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the NVE First Quarter Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Mr. Daniel Baker, President and CEO. Sir, you may begin.

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Thank you, and good afternoon. Welcome to our conference call for the quarter ended June 30, 2019. As always, I'm joined by Curt Reynders, our Chief Financial Officer. This call is being webcast live and being recorded. A replay will be available through our website, nve.com. After my opening comments, Curt will present our financial review of the quarter, I'll cover product development, trade shows and distribution and then we'll open the call to questions.

We issued our press release and filed our quarterly report on Form 10-Q in the past hour following the close of market. Links to documents are available through the SEC's website, our website and our Twitter time line. Comments we may make that relate to future plans, events, financial results or performance are forward-looking statements that are subject to certain risks and uncertainties including among others, such factors as risks and uncertainties related to future sales and revenue, risks related to changes in tariffs and other trade barriers as well as the risk factors listed from time to time in our filings with the SEC, including our annual report on Form 10-K for the year ended March 31, 2019. The company undertakes no obligation to update forward-looking statements we may make.

We're pleased to report 26% sequential growth in net income and important product launches this past quarter. Curt will cover details of the financial results, and then I'll cover the business. Curt?

Curt A. Reynders - *NVE Corporation - CFO, Treasurer & Secretary*

Thanks, Dan. For year-over-year comparisons, total revenue for the first quarter of fiscal 2020 decreased 11% to $6.29 million from $7.11 million in the first quarter of last year. The decrease was due to an 11% decrease in product sales and a 12% decrease in contract R&D from last year. Anti-tamper product sales were strong, but the medical device market continued to be weak. Sequentially, total revenue increased 13% compared to the quarter ended March 31, driven by a 13% increase in product sales. We're hoping for a third consecutive sequential revenue increase this quarter, which ends September 30.

Gross margin increased to a record 83% for the quarter from 80% in the first quarter last year due to a more profitable product mix. Expenses decreased 1% from the prior year due to a 2% decrease in R&D as we completed some important new product development projects. Dan will discuss product development in a few minutes.

Interest income for the first quarter increased 8% due to an increase in the average interest rates on our marketable securities and money market funds.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Net income for the quarter decreased 9% year-over-year to $3.61 million or $0.74 per diluted share compared to $3.95 million or $0.81 per share for the prior year quarter. Net margin was 57% of revenue, the highest ever. Net income increased 26% sequentially compared to the quarter ended March 31. Comprehensive income increased 9% to $4.18 million compared to $3.84 million for the prior year quarter. The increase was due to a $570,000 unrealized gain from marketable securities compared to a $107,000 unrealized loss in the prior year quarter, partially offset by a decrease in net income. The unrealized gain was due to a strong bond market. The comprehensive income helped us maintain our strong balance sheet while paying a generous dividend.

Cash flow from operations was $4.54 million in the first quarter. Cash flow is typically higher in the first quarter than in other quarters because we have no estimated income tax payments due. We have 2 tax payments due in the current quarter, the quarter ending September 30. The $1 per share or $4.85 million dividend this past quarter brought our total dividends paid to more than $90 million. We announced another quarterly dividend today payable August 30 to shareholders of record, July 29.

Now I'll turn it over to Dan to cover the business. Dan?

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Thanks, Curt. I'll cover product development, trade shows and sales. We recently introduced our fourth new smart sensor in the past year, a smart TMR magnetometer called the SM225. SM stands for smart magnetometer, which is designed to be used as a proximity or current sensor. It's faster, more accurate and smaller than alternatives. The new sensors are smart because unlike our legacy raw sensors, they include analog to digital conversion, digital factory calibration and digital interfaces in the IC. These features provide simple smart connectivity to the Internet of Things. TMR stands for Tunneling Magnetoresistance. Our spintronic technology such as TMR is ideal for smart sensors because of its inherent precision, small size and low power.

In addition to the new smart sensors, we continue to improve raw sensors with a new TMR magnetometer sensor designated the ALT025. TMR generally provides more signal and uses less energy than our venerable giant magnetoresistance or GMR technology. It can be used in a variety of industrial controls. Our new smart sensors have been well received. As an example, last week, we shipped a batch of smart angle sensors to a new customer for first production of an Internet of Things design win. We first talked to that customer in April. So it look barely 3 months to go from concept to production, which is quite remarkable.

The new product is a Bluetooth connected smart tape measure. Our smart angle sensor provided fast prototyping with simple interfacing and elegant architecture. It also offered the customer excellent accuracy and measurement speed. The revenues for this specific design win isn't huge, but the customer plans higher volume connected devices and it illustrates the power of the Internet of Things paradigm and the benefits of our smart sensors.

With the flurry of new products, we've stepped up our promotional efforts. In the past quarter, we exhibited at Sensors Expo in San Jose, which is billed as the industry's largest event dedicated to sensors, connectivity, and systems. There is a video of 3 of the demos we featured at the show on our YouTube channel and in the videos section of nve.com.

Additionally, one of our program managers, Dr. Joe Davies, presented a paper on our medical device sensors at the conference. His thought generated interest from several potential customers and we hope to broaden our medical business. New products were also on display the past quarter at shows in England and Germany in cooperation with our distributors there.

Looking even farther from home, in the past quarter, we shipped mission screen couplers for the Europa Clipper to the Jet Propulsion Laboratory. The parts held up well under extreme conditions. The trip from NVE to JPL in Pasadena was the first 1,500 miles of the part several hundred million mile trip to Europa, which is one of Jupiter's moons. The journey will include a launch in 4 years and a 3- to 6-year spaceflight. The mission is to look for conditions for life on Europa. Europe has been well studied recently and now, there's even more to explore. According to a recent study published in the journal, Science Advances, Europa has sodium chloride, which is the principal component of sea salt. According to NASA, this means Europa could be even more similar to the earth than previously thought.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Turning to sales, here on earth, we added an exceptionally capable representative in Europe, Dimac which is based in northern Italy. This will add a lot of feet on the street for us in Europe. We've had several training sessions with Dimac's key people throughout Europe and we've been impressed with their sales skill and technical savvy.

Our annual shareholders' meeting will be August 1 here in Eden Prairie. We'll demonstrate several new products, including smart sensors, which we didn't have last year. We'll also celebrate NVE's 30-year anniversary with a birthday cake and we'll have the smart sensor-based mechatronic xylophone play happy birthday. The materials for the formal meeting are proxy statement letter to shareholders and annual report on Form 10-K have been filed with the SEC and are available from the Investors section of our website.

Shareholders can still vote their shares via mail, phone or on proxyvote.com. There are 3 items on the formal agenda for the meeting. First to elect directors; second, advisory approval of the compensation of our named executive officers; and third, to ratify the selection of an accounting firm.

For good corporate practice, our entire Board of Directors stands for reelection every year and we were fortunate to have an exceptionally experienced and accomplished board. The second meeting agenda item is approval of officer compensation. As discussed in our proxy, we don't overpay our officers. Our officers have the same fringe benefits as all other employees and there are no executive perks or golden parachutes. The third annual meeting agenda item is the ratification of our auditors. Last year -- last quarter rather, we engaged a new accounting firm, Boulay PLLP, after 6 years with Grant Thornton. Shareholders had the opportunity to vote on Boulay as our auditors for the fiscal year ending March 31, 2020. Audit firm rotation is considered good governance and Boulay is smart, efficient and experienced working with smaller public companies.

Our Board unanimously recommends the ratification. Boulay representatives will be at the upcoming annual meeting and will be available to answer questions.

Now I'd like to open the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Jeff Bernstein with Cowen.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Just a couple of questions for you. I guess so Abbott reported and their CRM business continues to be down a little bit, although they were optimistic that they might actually turn that around. Can you just talk about what kind of visibility you have there and talk a little bit about any other med device guys that you have business with? Now I know you have mentioned neurostimulators in the past.

Curt A. Reynders - *NVE Corporation - CFO, Treasurer & Secretary*

Sure. I believe Abbott reported that they did have sequential sales growth in the quarter. We're looking at also having sequential sales growth in the -- in our third quarter, which would be our third consecutive quarter of sequential growth and we're expecting in the third quarter, we will return to year-over-year growth.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Great. And can you just elaborate little bit on -- Abbott's obviously a very big customer, is there anybody in this business, any other competitors in CRM that you're designed into?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

This is Dan. Good afternoon, Jeff. It would probably be -- not be a good idea for us to talk about other customers that -- we can talk about Abbott because we have disclosed that they are a customer in our SEC filings. But as you can imagine, we are very strong in the CRM market. We're very strong in the medical device market in general. We have an excellent reputation. And we're willing to invest in businesses that sometimes take many years to get design wins. So you can expect that we would be in contact with the leaders in that space and working on new devices as well as potential replacements in existing devices. You also touched on the broader neurostimulator market, which is also a strong market for us and sometimes these devices share common platforms. Often they have the same technical challenges, battery life, small size and the reliability that's so critical in a life support medical device, class 3 medical device. So that's a strong market for us. It's been challenging, as you alluded to and -- but the long-term demographics are very positive. People are -- the population is aging. We're going to need more medical devices. The therapies are extending into more and more disease processes so more and more people can be helped for these devices. So we see it is an excellent long-term market although the device market has been challenging in the relatively -- in the recent past, in the near term future.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Got you. And can you just say in neurostimulators, are you guys particularly focused on applications in pain or depression? Or is there anything in particular or are you involved in an array of programs?

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

We're looking at an array of programs. We do tend to look at -- I mean we're willing to invest in the long term and so implantable medical devices, class 3 life support medical devices have as you might expect, as you know, significant regulatory hurdles and they take -- often can take a long time to get approved. So devices that are less critical can sometimes be shorter design cycles and obviously, that's preferable from a business standpoint. So those would be things like pain management, pain stimulators. You mentioned other types of simulators. There's some exciting research going on in neurostimulators relating to brain stimulation to treat neurological and psychiatric disorders. So we have an excellent benefit proposition and a strong market presence in those markets. We're always looking to say how can we get into the market sooner. So for neurostimulators, it's the pain stimulators and for other medical devices, things like hearing aids and devices that are class 1 medical devices we can get to market sooner.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Got you. Okay. And then I was just wondering, in the K, you talked about -- you added power conversion ICs to your list of long-term product development programs and you took out medical diagnostics, and -- so I'm just curious about those 2 changes.

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Well, you have a sharp eye. So the power control devices are devices that we're looking at for sophisticated motor control, such as power factor controls. So these are devices that can improve the efficiency and the power utilization of motors and other what are called nonlinear devices. So that's an area where we think our partnership with a large semi-conductor company can bring some benefits because they have expertise and a market presence in the IC part of it and we can provide the isolation and sensing. So it's a great potential area for us and one that's becoming more and more important. There's a statistic and I might not have the exact numbers right, but nearly half of the electric power in the world is used by motors and that's an amazing statistic. Some of it's big heavy motors as you might expect, but there's a lot of little motors that are in a whole bunch of things.

So being able to manage those more efficiently is more and more important. It's getting more and more regulatory attention and scrutiny and more and more attention from companies like ours and our partners. So one of the challenges that we can help with is to efficiently drive the motors with our coupler technology without having to have a direct electrical connection. So the flip side of that was that I think that you mentioned

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

was medical diagnostics. And medical diagnostic remains an area of interest for us. There is a certain time frame that might kick into a regulatory filing, but we mentioned in particular, as you know, that our biosensor technology may have applicability to exosome detection, which could be used for early-stage cancer detection. That's a very exciting area and an area that we're continuing to pursue. So we certainly wouldn't want you to read into that that we've abandoned that market, quite the contrary.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Got you. Okay. And just to clarify, so it is isolation and I guess, current sensing in power conversion, you're not actually doing power conversion ICs yourself?

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Well, we haven't defined exactly how the pie will be split, but our core competencies are in current sensing and in isolation, and those are key areas for those power conversion circuits. So the circuitry is getting more and more integrated to reduce the parts count, to get them into small devices and into smaller and smaller motors and smaller power supply. So that's where we think a lot of value can be added. There have been power control circuits for some time, but they require ancillary products and they don't have the speed and the other advantages that our isolation technology has to improve the efficiency.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Got you. Okay. And then one last one and I'll hand it over to somebody else. You no longer listed Premier Farnell plc as a distribution partner. Is that relationship changed? Has it been replaced by somebody else or what was going on there?

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

No, the company was purchased. So it's still a distributor. So in the United States, it would be through Newark element14. I believe that's their -- that's still their current branding. The parent company is different, but we're still on their website and in their catalog and they're a good distributor.

Operator

(Operator Instructions) And our next question comes from Thomas Cochran with Lake Road Partners.

Thomas N. Cochran

Dan, I'm thinking about the biosensor or bacteria detection devices and I know that NVE only has perhaps 50 employees. If that device, the biosensor device is successful, will NVEC be able to supply the market? Or do you anticipate selling the manufacturing rights and patents to another company? I worry a little that big food companies or medical products companies, people who're going to use medical products might prefer to buy the device, say your cancer detector from an established machinery maker that knows how to comply with all the government regulations involved in food production or medical products. It seems to me that a company that's new to them, just getting approved as a supplier could be a long process.

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Yes. Well, that's a very good question, Tom, and it is a possibility that we could license the technology or arrange a private label partnership. There's still development work to do, but we've done private label arrangements where we combine our technology with a larger company's sales and marketing muscle and their support infrastructure. On the other hand, we've said and we are prepared to market it ourselves if necessary. There

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

are challenges in that as you correctly point out, but our USDA application include a letter of support from a major food wholesaler. So the implication there is they're willing to work with us despite our relative lack of experience in that marketplace and we're prepared to hire salespeople and others at the appropriate time. So we will do -- we will look at what is the best way to bring the technology to market and we could do it either way.

Thomas N. Cochran

Okay. If the patents were sold to another company, it's my belief that NVE could set up a pass-through shell, which would distribute the initial and later payments for the patents directly to NVE shareholders, that proceeds would not then be taxed to NVE but only to holders -- to the shareholders. The same pass-through arrangements might be used for future uses of the same patent pool. It just seems to me that might be another reason for licensing it out.

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Yes. While there's certainly pros and cons, and we share your goal of returning capital to shareholders as tax efficiently as possible. So our plan has been to manufacture the equipment and certainly the sensors. We have unique manufacturing capabilities. So licensing is a little bit more of a challenge there than it might be for other technologies, such as large-scale spintronic memories. But it is a possibility and we would look at what maximizes our shareholders' value and do what's best for our shareholders. That's what we try to do with everything -- every business decision we make.

Operator

And our next question comes from Jeff Bernstein with Cowen.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Just a couple of quick follow-ups. Can you just give us a little more insight into the unclonable function business? I guess it came back, this quarter, it's -- you've said in the past, it's a lumpy business. Is it a high ASP part, is it -- can you give us any idea of the end -- kind of hardware that's going into it, I know you'd have to kill me, but missile defense, aircraft or drone, vessels or kind of where do these things go, and just any insight we could get to understand a little bit more about it.

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Sure. So first, for folks who aren't familiar with it, PUFs or physical unclonable functions and those are functions that are embodied in a physical structure that's easy to evaluate, but hard to predict and replicate. So they are an important component in anti-tamper systems. The anti-tamper systems that we work on are designed to protect sensitive data or electronics. We currently sell these for military systems. There are potential commercial applications, such as high-speed encryption and security for consumer electronics. But in the near term, they've been used for military systems. So what the military has said publicly is that when we sell -- when we as a country sell military systems, they need to be protected because they can be, of course, there's a potential they could fall into unfriendly hands, reverse engineered. So that's particularly sensitive for exported military systems. So they do tend to be -- so you're asking also about the business and characterizing the business. They do tend to be high value-added systems, as you can imagine.

There is a different price point for something like an anti-tamper system for a military system and commercial applications, such as consumer electronics and the requirements are much more rigorous, the testing that we do on these devices is extremely precise and rigorous, as you would hope. So those tend to be high value-added systems where they are relatively expensive to make. I guess I would characterize them as the margins can vary. They can be good, but then if one runs into challenges, as they can be fairly expensive to remedy. So in that sense, it can be variable but I think as Curt mentioned, overall, our margins were record -- we had record margins in the most recent quarter and he referred to the mix and so part of that mix is a -- is some strength in the anti-tamper business.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Great. And so I guess, you can't really give us any details on what kinds of hardware these things go into?

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Probably, I think we've been about as specific as we could. So they are going into military electronics, sensitive data or electronics, and electronics is more and more an important part of many military systems, as you can imagine. There is some information and links to information from government agencies, such as there's an abstract that was approved by the missile defense agency for public release in the News section of our website, but beyond that, as you might expect, we're limited in what we can say about anti-tamper technologies.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Got you. Okay. And then on -- in your K, you also talked about private label couplers that were added to the list of the products that you offer. Can you just explain what private label couplers are? Is that part of your partnership with the large semi-company?

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Yes. And so we sell couplers under other company's brand names where we're making the parts and -- but as Tom mentioned in the context of biosensors, there are customers who would prefer to buy from a bigger name or a bigger company. We certainly feel like we provide our customers with superb support and excellent product quality, but we understand that and also there are just inherent limits to our reach and accessibility being a relatively small company based here in the United States. So we do see the value of having our products under private label arrangements and it appeals to a different type of customers. So we don't believe there is an awful lot of cannibalization in that type of business model and it's one that we think that, as I alluded to in the other question, that we're open to and where it makes business sense, we've been looking at those sorts of arrangements.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to Daniel Baker for any closing remarks.

Daniel A. Baker - *NVE Corporation - CEO, President & Director*

Well, thank you. We were pleased to report strong sequential growth, record margins in 2 new products. We look forward to seeing some of you at our Annual Shareholders Meetings 2 weeks from tomorrow and to speaking with you again in October to discuss second quarter results. Thank you for participating in the call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Everyone, have a wonderful day.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019, Thomson Reuters. All Rights Reserved.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS