

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported): August 6, 2020

PDF SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

000-31311

(Commission File Number)

Delaware

(State or Other Jurisdiction of Incorporation)

25-1701361

(I.R.S. Employer Identification No.)

2858 De La Cruz Boulevard

Santa Clara, CA 95050

(Address of principal executive offices, with zip code)

(408) 280-7900

(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Securities registered pursuant to Section 12(b) of the Exchange Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|-----------------------------------|-------------------|---|
| Common Stock, \$0.00015 par value | PDFS | The NASDAQ Stock Market LLC |

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 or Rule 12b-2 of the Securities Exchange Act of 1934.

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Item 2.02. Results of Operations and Financial Condition.

On August 6, 2020 PDF Solutions (the “Company”) issued a press release regarding its financial results and certain other information related to the second quarter of 2020. The Company also posted on the Investors section of its website (www.pdf.com) a management report with regard to the second quarter of 2020. Copies of the press release and management report are attached to this report as Exhibit 99.1 and 99.2, respectively. Information on the website is not, and will not be deemed, a part of this report or incorporated into any other filings the Company makes with the Securities and Exchange Commission.

The information in this Item 2.02, including Exhibits 99.1 and 99.2, is being furnished and shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or otherwise subject to the liabilities under that Section, and shall not be deemed incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

Item 9.01. Financial Statements and Exhibits.

(d) Exhibits

| <u>Exhibit No.</u> | <u>Description</u> |
|--------------------|--|
| 99.1 | Press Release dated August 6, 2020, regarding financial results and certain other information related to the second quarter of 2020. |
| 99.2 | Management Report by PDF Solutions, Inc. as of August 6, 2020. |
| 104 | Cover Page Interactive Data File (embedded within the Inline XBRL document) |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

PDF SOLUTIONS, INC.
(Registrant)

By: /s/ Adnan Raza
Adnan Raza
EVP, Finance, and Chief Financial Officer
(principal financial and accounting officer)

Dated: August 6, 2020

News Release

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PDF Solutions® Reports Second Quarter 2020 Results

Business Highlights

- Total revenues of \$21.4 million, up 4% over last year's comparable quarter
- Analytics revenue of \$15.2 million, up 27% over last year's comparable quarter
- Analytics accounted for 71% of second quarter revenues
- GAAP Gross Margin of 58% for the second quarter of 2020
- Non-GAAP Gross Margin of 63% for the second quarter of 2020
- Operating activities generated \$5.2 million in cash during the second quarter of 2020
- Cash and cash equivalents of \$103.4 million at the end of second quarter of 2020

SANTA CLARA, Calif. — Thursday, August 6, 2020 — PDF Solutions, Inc. ("PDF Solutions" or the "Company") (NASDAQ: PDFS), a leading provider of differentiated data and analytics solutions to the semiconductor and electronics industries, today announced financial results for its second quarter ended June 30, 2020.

Highlights of Second Quarter 2020 Financial Results

Total revenues for the second quarter of 2020 were \$21.4 million, compared to \$21.2 million for the first quarter of 2020 and \$20.6 million for the second quarter of 2019. Analytics revenue for the second quarter of 2020 was \$15.2 million, compared to \$13.2 million for the first quarter of 2020 and \$12.0 million for the second quarter of 2019. Integrated Yield Ramp revenue for the second quarter of 2020 was \$6.2 million, compared to \$7.9 million for the first quarter of 2020 and \$8.6 million for the second quarter of 2019.

GAAP gross margin for the second quarter of 2020 was 58%, compared to 60% for the first quarter of 2020 and 62% for the second quarter of 2019.

Non-GAAP gross margin for the second quarter of 2020 was 63%, compared to 65% for the first quarter of 2020 and 67% for the second quarter of 2019.

On a GAAP basis, net loss for the second quarter of 2020 was \$3.7 million, or (\$0.11) per basic and diluted share, compared to a net loss of \$0.5 million, or (\$0.02) per basic and diluted share, for the first quarter of 2020, and compared to a net loss of \$0.7 million, or (\$0.02) per basic and diluted share, for the second quarter of 2019.

PDF Solutions® Reports Second Quarter 2020 Results

Non-GAAP net income for the second quarter of 2020 was \$0.5 million, or \$0.01 per diluted share, compared to a net loss of \$0.1 million, or (\$0.00) per diluted share, for the first quarter of 2020, and compared to net income of \$1.0 million, or \$0.03 per diluted share, for the second quarter of 2019.

Cash and cash equivalents at June 30, 2020, were \$103.4 million, compared to \$97.6 million at December 31, 2019, an increase of \$5.8 million. Operating activities generated \$5.2 million in cash during the second quarter of 2020.

Conference Call

As previously announced, PDF Solutions will discuss these results on a live conference call beginning at 2:00 p.m. Pacific Time / 5:00 p.m. Eastern Time today. The call will be simultaneously webcast on PDF Solutions' website at <http://ir.pdf.com/webcasts>. A replay of the webcast will be available at the same website address beginning approximately two hours after completion of the live call. A copy of this press release, including the disclosure and reconciliation of certain non-GAAP financial measures to the comparable GAAP measures, which non-GAAP measures may be used periodically by PDF Solutions' management when discussing financial results with investors and analysts, will also be available on PDF Solutions' website at <http://www.pdf.com/press-releases> following the date of this release.

Second Quarter 2020 Financial Commentary Available Online

A Management Report reviewing the Company's second quarter of 2020 financial results will be furnished to the SEC on Form 8-K and published on the Company's website at <http://ir.pdf.com/financial-reports>. Analysts and investors are encouraged to review this commentary prior to participating in the conference call.

Information Regarding Use of Non-GAAP Financial Measures

In addition to providing results that are determined in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP), PDF Solutions also provides certain non-GAAP financial measures. Non-GAAP net income (loss) excludes the effects of non-recurring items (including restructuring charges and severance payments, and expenses related to an arbitration proceeding for a disputed contract with a customer), write-down in value of property and equipment, stock-based compensation expense, amortization of acquired technology and other acquired intangible assets, and their related income tax effects, as applicable, as well as adjustments for the non-cash portion of income taxes and tax impact of the CARES Act. These non-GAAP financial measures are used by management internally to measure the Company's profitability and performance. PDF Solutions' management believes that these non-GAAP measures provide useful supplemental information to investors regarding the Company's ongoing operations in light of the fact that none of these categories of expense has a current effect on the future uses of cash (with the exception of certain non-recurring items) nor do they impact the generation of current or future revenues. These non-GAAP results should not be considered an alternative to, or a substitute for, GAAP financial information, and may differ from similarly titled non-GAAP measures used by other companies. In particular, these non-GAAP financial measures are not a substitute for GAAP measures of income or loss as a measure of performance, or to cash flows from operating, investing and financing activities as a measure of liquidity. Since management uses these non-GAAP financial measures internally to measure profitability and performance, PDF Solutions has included these non-GAAP measures to give investors an opportunity to see the Company's financial results as viewed by management. A reconciliation of the comparable GAAP financial measures to the non-GAAP financial measures is provided at the end of the Company's financial statements presented below.

Forward-Looking Statements

The statements planned to be made on the planned conference call regarding the Company's future expected business performance and financial results and the Company's recent strategic agreement with Advantest are forward looking and are subject to future events and circumstances. Actual results could differ materially from those expressed in these forward-looking statements. Risks and uncertainties that could cause results to differ materially include risks associated with: customers' production volumes under contracts that provide Gainshare royalties, cost and schedule of new product development; continued adoption of the Company's solutions by new and existing customers; project milestones or delays and performance criteria achieved; the provision of technology and services prior to the execution of a final contract, the potential impact of the coronavirus (COVID-19) on the semiconductor industry and on the Company's operations or demand for the Company's products; the Company's strategic partnerships; and other risks set forth in PDF Solutions' periodic public filings with the Securities and Exchange Commission, including, without limitation, its Annual Reports on Form 10-K, most recently filed for the year ended December 31, 2019, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K and amendments to such reports. The forward-looking statements made in the conference call are made as of the date hereof, and PDF Solutions does not assume any obligation to update such statements nor the reasons why actual results could differ materially from those projected in such statements.

About PDF Solutions

PDF Solutions (NASDAQ: PDFS) offers an end-to-end analytics platform that empowers engineers and data scientists across the semiconductor ecosystem to rapidly improve the yield, quality, and profitability of their products. By combining industry-leading data analytics and professional services with exclusive, differentiated product data generated during the manufacturing process, PDF Solutions is delivering on the promise of Industry 4.0 today by transforming how the ecosystem collects, analyzes, and shares data. Key Fortune 500 organizations around the world rely on PDF Solutions to remove the data barriers that encumber and constrain new product introductions and to deliver the machine learning insights that drive efficient and profitable high-volume manufacturing.

Headquartered in Santa Clara, California, PDF Solutions also operates worldwide in Canada, China, France, Germany, Italy, Japan, Korea, and Taiwan. For the Company's latest news and information, visit <http://www.pdf.com/>.

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PDF SOLUTIONS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(In thousands)

| | June 30, 2020 | December 31, 2019 |
|---|-------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 103,441 | \$ 97,605 |
| Accounts receivable, net | 28,666 | 40,651 |
| Prepaid expenses and other current assets | 8,627 | 9,320 |
| Total current assets | 140,734 | 147,576 |
| Property and equipment, net | 40,412 | 40,798 |
| Operating lease right-of-use assets, net | 7,056 | 7,609 |
| Goodwill | 2,293 | 2,293 |
| Intangible assets, net | 5,586 | 6,221 |
| Deferred tax assets, net | 29,522 | 25,327 |
| Other non-current assets | 8,093 | 9,720 |
| Total assets | <u>\$ 233,696</u> | <u>\$ 239,544</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,763 | \$ 7,636 |
| Accrued compensation and related benefits | 5,285 | 5,072 |
| Accrued and other current liabilities | 1,368 | 1,665 |
| Operating lease liabilities – current portion | 1,880 | 1,867 |
| Deferred revenues – current portion | 10,087 | 10,639 |
| Billings in excess of recognized revenues | 497 | 1,117 |
| Total current liabilities | 21,880 | 27,996 |
| Long-term income taxes payable | 5,264 | 5,368 |
| Non-current operating lease liabilities | 7,033 | 7,677 |
| Other non-current liabilities | 1,814 | 2,346 |
| Total liabilities | <u>35,991</u> | <u>43,387</u> |
| Stockholders' equity: | | |
| Common stock and additional paid-in-capital | \$ 333,162 | \$ 325,202 |
| Treasury stock at cost | (93,968) | (91,695) |
| Accumulated deficit | (40,050) | (35,870) |
| Accumulated other comprehensive loss | (1,439) | (1,480) |
| Total stockholders' equity | 197,705 | 196,157 |
| Total liabilities and stockholders' equity | <u>\$ 233,696</u> | <u>\$ 239,544</u> |

PDF SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share amounts)

| | Three months ended | | | Six months ended | |
|--|--------------------|-------------------|----------------------|-------------------|----------------------|
| | June 30, 2020 | March 31, 2020 | June 30, 2019 (1) | June 30, 2020 | June 30, 2019 (1) |
| Revenues: | | | | | |
| Analytics | \$ 15,172 | \$ 13,248 | \$ 11,974 | \$ 28,420 | \$ 23,408 |
| Integrated yield ramp | 6,237 | 7,910 | 8,594 | 14,147 | 17,701 |
| Total revenues | <u>21,409</u> | <u>21,158</u> | <u>20,568</u> | <u>42,567</u> | <u>41,109</u> |
| Costs and Expenses: | | | | | |
| Costs of revenues | 8,946 | 8,487 | 7,832 | 17,433 | 15,700 |
| Research and development | 7,754 | 8,590 | 7,312 | 16,344 | 15,558 |
| Selling, general and administrative | 7,737 | 7,895 | 6,940 | 15,632 | 13,950 |
| Amortization of other acquired intangible assets | 174 | 173 | 154 | 347 | 262 |
| Restructuring charges | — | — | — | — | 92 |
| Interest and other expense (income), net | 150 | 20 | (111) | 170 | (105) |
| Loss before income taxes | (3,352) | (4,007) | (1,559) | (7,359) | (4,348) |
| Income tax expense (benefit) | 300 | (3,479) | (849) | (3,179) | (947) |
| Net loss | <u>\$ (3,652)</u> | <u>\$ (528)</u> | <u>\$ (710)</u> | <u>\$ (4,180)</u> | <u>\$ (3,401)</u> |
| Net loss per share: | | | | | |
| Basic | \$ (0.11) | \$ (0.02) | \$ (0.02) | \$ (0.13) | \$ (0.10) |
| Diluted | <u>\$ (0.11)</u> | <u>\$ (0.02)</u> | <u>\$ (0.02)</u> | <u>\$ (0.13)</u> | <u>\$ (0.10)</u> |
| Weighted average common shares: | | | | | |
| Basic | 32,886 | 32,703 | 32,339 | 32,795 | 32,412 |
| Diluted | 32,886 | 32,703 | 32,339 | 32,795 | 32,412 |

(1) In the fourth quarter of 2019, in order to improve the transparency of the Company's revenue reporting, the Company updated its Condensed Consolidated Statements of Comprehensive Loss to change its historical presentation of revenue categories. Previously, the Company presented revenue on two lines: Solutions and Gainshare performance incentives. Included within Solutions, was revenue from software and related revenue, SaaS solutions, Design-for-Inspection (DFI™) licenses, and fixed-price project-based solution implementation services. The previous Gainshare performance incentive category included only revenue from performance incentive programs. The Company now presents revenue in the following categories: Analytics and Integrated Yield Ramp. Integrated Yield Ramp revenue is comprised of all revenue from the Company's Integrated Yield Ramp services engagements that include performance incentives based on customers' yield achievement, i.e. both fixed-fees and Gainshare royalty from such engagements. Analytics comprises all other revenue, including from the Company's licenses and services for Exensio Software, Exensio SaaS, DFI™ and Characterization Vehicle systems that do not include performance incentives based on customers' yield achievement. This prior period presentation had been reclassified to conform to the new revenue presentation.

PDF SOLUTIONS, INC.
 RECONCILIATION OF GAAP TO NON-GAAP GROSS MARGIN (UNAUDITED)
 (In thousands)

| | Three months ended | | | Six months ended | |
|---|--------------------|-------------------|------------------|------------------|------------------|
| | June 30, 2020 | March 31, 2020 | June 30, 2019 | June 30, 2020 | June 30, 2019 |
| GAAP | | | | | |
| Total revenues | \$ 21,409 | \$ 21,158 | \$ 20,568 | \$ 42,567 | \$ 41,109 |
| Costs of revenues | 8,946 | 8,487 | 7,832 | 17,433 | 15,700 |
| GAAP gross profit | \$ 12,463 | \$ 12,671 | \$ 12,736 | \$ 25,134 | \$ 25,409 |
| GAAP gross margin | 58% | 60% | 62% | 59% | 62% |
| Non-GAAP | | | | | |
| GAAP gross profit | \$ 12,463 | \$ 12,671 | \$ 12,736 | \$ 25,134 | \$ 25,409 |
| Adjustments to reconcile GAAP to non-GAAP gross margin: | | | | | |
| Stock-based compensation expense | 883 | 909 | 799 | 1,792 | 1,659 |
| Amortization of acquired technology | 143 | 144 | 143 | 287 | 287 |
| Non-GAAP gross profit | \$ 13,489 | \$ 13,724 | \$ 13,678 | \$ 27,213 | \$ 27,355 |
| Non-GAAP gross margin | 63% | 65% | 67% | 64% | 67% |

PDF SOLUTIONS, INC.
RECONCILIATION OF GAAP TO NON-GAAP NET INCOME (LOSS) (UNAUDITED)
(In thousands, except per share amounts)

| | Three months ended | | | Six months ended | |
|---|--------------------|-------------------|------------------|------------------|------------------|
| | June 30, 2020 | March 31, 2020 | June 30, 2019 | June 30, 2020 | June 30, 2019 |
| GAAP net loss | \$ (3,652) | \$ (528) | \$ (710) | \$ (4,180) | \$ (3,401) |
| Adjustments to reconcile GAAP net loss to non-GAAP net income (loss): | | | | | |
| Stock-based compensation expense | 2,978 | 3,368 | 2,434 | 6,346 | 5,910 |
| Amortization of acquired technology | 143 | 144 | 143 | 287 | 287 |
| Amortization of other acquired intangible assets | 174 | 173 | 154 | 347 | 262 |
| Expenses of arbitration (1) | 363 | 101 | — | 464 | — |
| Write-down in value of property and equipment | 311 | — | — | 311 | — |
| Restructuring charges and severance payments | — | — | — | — | 92 |
| Tax impact of adjustments | 167 | (1,143) | (993) | (976) | (1,280) |
| Tax impact of the CARES Act (2) | — | (2,261) | — | (2,261) | — |
| Non-GAAP net income (loss) | <u>\$ 484</u> | <u>\$ (146)</u> | <u>\$ 1,028</u> | <u>\$ 338</u> | <u>\$ 1,870</u> |
| GAAP net loss per diluted share | <u>\$ (0.11)</u> | <u>\$ (0.02)</u> | <u>\$ (0.02)</u> | <u>\$ (0.13)</u> | <u>\$ (0.10)</u> |
| Non-GAAP net income (loss) per diluted share | <u>\$ 0.01</u> | <u>\$ (0.00)</u> | <u>\$ 0.03</u> | <u>\$ 0.01</u> | <u>\$ 0.06</u> |
| Shares used in diluted shares calculation | <u>33,874</u> | <u>32,703</u> | <u>33,055</u> | <u>33,718</u> | <u>33,038</u> |

(1) Represents the expenses related to an arbitration proceeding over a disputed contract with a customer, which expenses are expected to continue until the arbitration is resolved.

(2) Represents the discrete tax benefit recognized from the carryback of net operating losses (NOLs) under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) enacted in March 2020. The Company does not have any NOLs on a non-GAAP basis and, therefore, it did not recognize this discrete tax benefit in calculating its non-GAAP tax expense and net income (loss).



PDF/SOLUTIONS™

**Q2 2020
Management Report
August 6, 2020**

Contents

■ Q2 2020 Results

- Overview
- Revenue by Geographic Area
- Key Financial & Operating Metrics

■ Q2 2020 Non-GAAP Results

- Reconciliation of GAAP to Non-GAAP Net Income (Loss)
- Reconciliation of GAAP to Non-GAAP Spending by Function

■ Related Information

The following commentary is provided by management and should be referenced in conjunction with PDF Solutions' second quarter of 2020 financial results press release available on its Investor Relations website at <http://www.pdf.com/financial-news>. These remarks represent management's current views of the Company's financial and operational performance and are provided to give investors and analysts further insight into its performance in advance of the earnings call webcast. The Company disclaims any duty to update this information for future events.

PDF Solutions Reports Second Quarter 2020 Results

Q2 2020 Key Metrics

Revenue: \$21.4M

GAAP Gross Margin: 58%

Non-GAAP Gross Margin: 63%

GAAP EPS: (\$0.11)

Non-GAAP EPS: \$0.01

Operating Cash Flow: \$5.2M

Capital Expenditures: \$1.9M

FINANCIAL RESULTS SUMMARY

- Q2 2020 Total revenues of \$21.4M, up 1% over Q1 2020, and up 4% over Q2 2019.
- Q2 2020 Analytics revenue of \$15.2M, up 15% over Q1 2020, and up 27% over Q2 2019.
- Q2 2020 Integrated yield ramp revenue of \$6.2M, down 22% over Q1 2020, and down 28% over Q2 2019.

Revenue by Geographic Area

(Dollars in thousands)

| | <u>Q2'20</u> | <u>Q1'20</u> | <u>Q4'19</u> | <u>Q3'19</u> | <u>Q2'19</u> |
|-----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| North America | \$9,969 | \$8,687 | \$11,007 | \$7,384 | \$8,636 |
| % of Total | 46% | 41% | 49% | 34% | 42% |
| Europe | \$3,983 | \$3,561 | \$3,363 | \$3,355 | \$3,147 |
| % of Total | 19% | 17% | 15% | 15% | 15% |
| APAC | 7,457 | \$8,910 | \$8,192 | \$11,175 | \$8,785 |
| % of Total | 35% | 42% | 36% | 51% | 43% |
| Total revenues | \$21,409 | \$21,158 | \$22,562 | \$21,914 | \$20,568 |

Key Financial & Operating Metrics – Quarterly

(in thousands, except share data, which is in millions, and percentages)

| | <u>Q2'20</u> | <u>Q1'20</u> | <u>Q4'19</u> | <u>Q3'19</u> | <u>Q2'19</u> |
|--|--------------|--------------|--------------|--------------|--------------|
| Revenues | \$21,409 | \$21,158 | \$22,562 | \$21,914 | \$20,568 |
| GAAP Gross Margin | 58% | 60% | 60% | 60% | 62% |
| Non-GAAP Gross Margin | 63% | 65% | 64% | 64% | 67% |
| Outstanding Debt | \$0 | \$0 | \$0 | \$0 | \$0 |
| Operating Cash Flow | \$5,250 | \$5,380 | \$1,579 | \$18,045 | \$5,117 |
| Capital Expenditures (CAPEX) | \$1,872 | \$2,068 | \$3,711 | \$2,837 | \$1,697 |
| \$ Shares Repurchased | \$0 | \$0 | \$0 | \$1,932 | \$3,790 |
| Weighted Average Common Shares Outstanding | 32.9 | 32.7 | 32.4 | 32.4 | 32.3 |
| Effective Tax Rate Benefit (Expense) | (9%) | 87% | 27% | 43% | 54% |

GAAP / Non-GAAP Presentation

In addition to providing results that are determined in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP), the Company also provides certain non-GAAP financial measures. Non-GAAP gross margin and Non-GAAP net income (loss) exclude the effects of non-recurring items (including adjustment to contingent consideration related to acquisition, and expenses related to an arbitration proceeding for a disputed contract with a customer), write-down in value of property and equipment, stock-based compensation expenses, amortization of acquired technology and other acquired intangible assets, and their related income tax effects, as applicable, as well as adjustments for the non-cash portion of income taxes and tax impact of the CARES Act. These non-GAAP financial measures are used by management internally to measure the Company's profitability and performance. PDF Solutions' management believes that these non-GAAP measures provide useful supplemental measures to investors regarding the Company's ongoing operations in light of the fact that none of these categories of expense has a current effect on the future uses of cash (with the exception of certain non-recurring items) nor do they impact the generation of current or future revenues. These non-GAAP results should not be considered an alternative to, or a substitute for, GAAP financial information, and may be different from similarly titled non-GAAP measures used by other companies. In particular, these non-GAAP financial measures are not a substitute for GAAP measures of income or loss as a measure of performance, or to cash flows from operating, investing and financing activities as a measure of liquidity. Management uses these non-GAAP financial measures internally to measure profitability and performance; these non-GAAP measures are presented here to give investors an opportunity to see the Company's financial results as viewed by management. A detailed reconciliation of the adjustments made to comparable GAAP measures is included herein.

Reconciliation of GAAP to Non-GAAP Net Income (Loss)

(in thousands, except for shares and per share amounts)

| | Q2'20 | Q1'20 | Q4'19 | Q3'19 | Q2'19 |
|---|------------|-----------|------------|-----------|-----------|
| GAAP net loss | \$ (3,652) | \$ (528) | \$ (1,330) | \$ (687) | \$ (710) |
| Adjustments to reconcile GAAP net loss to non-GAAP net income (loss): | | | | | |
| Stock-based compensation expense | 2,978 | 3,368 | 2,782 | 2,732 | 2,434 |
| Amortization of acquired technology | 143 | 144 | 143 | 144 | 143 |
| Amortization of other acquired intangible assets | 174 | 173 | 173 | 174 | 154 |
| Expenses of arbitration (1) | 363 | 101 | — | — | — |
| Write-down in value of property and equipment | 311 | — | — | — | — |
| Adjustment to contingent consideration related to acquisition | — | — | — | 30 | — |
| Tax impact of adjustments | 167 | (1,143) | (700) | (805) | (993) |
| Tax impact of the CARES Act (2) | — | (2,261) | — | — | — |
| Non-GAAP net income (loss) | \$ 484 | \$ (146) | \$ 1,068 | \$ 1,588 | \$ 1,028 |
| GAAP net loss per diluted share | \$ (0.11) | \$ (0.02) | \$ (0.04) | \$ (0.02) | \$ (0.02) |
| Non-GAAP net income (loss) per diluted share | \$ 0.01 | \$ (0.00) | \$ 0.03 | \$ 0.05 | \$ 0.03 |
| Shares used in diluted shares calculation | 33,874 | 32,703 | 33,414 | 32,997 | 33,055 |

(1) Represents the expenses related to an arbitration proceeding over a disputed contract with a customer, which expenses are expected to continue until the arbitration is resolved.

(2) Represents the discrete tax benefit recognized from the carryback of net operating losses (NOLs) under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") enacted in March 2020. The Company does not have any NOLs on a non-GAAP basis and, therefore, it did not recognize this discrete tax benefit in calculating its non-GAAP tax expense and net income (loss).

Reconciliation of GAAP to Non-GAAP Spending by Function

(in thousands)

| | Q2'20 | Q1'20 | Q4'19 | Q3'19 | Q2'19 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| Cost of Revenue - GAAP | \$ 8,946 | \$ 8,487 | \$ 9,059 | \$ 8,715 | \$ 7,832 |
| Adjustments to reconcile GAAP Cost of Revenue to non-GAAP Cost of Revenue: | | | | | |
| Stock-based compensation expense | (883) | (909) | (782) | (745) | (799) |
| Amortization of acquired technology | (143) | (144) | (143) | (144) | (143) |
| Cost of Revenue - Non-GAAP | \$ 7,920 | \$ 7,434 | \$ 8,134 | \$ 7,826 | \$ 6,890 |
| Research & Development - GAAP | \$ 7,754 | \$ 8,590 | \$ 8,754 | \$ 8,435 | \$ 7,312 |
| Adjustments to reconcile GAAP R&D to non-GAAP R&D: | | | | | |
| Stock-based compensation expense | (1,010) | (1,455) | (1,083) | (1,062) | (901) |
| Write-down in value of property and equipment | (149) | — | — | — | — |
| Adjustment to contingent consideration related to acquisition | — | — | — | (30) | — |
| Research & Development - Non-GAAP | \$ 6,595 | \$ 7,135 | \$ 7,671 | \$ 7,343 | \$ 6,411 |
| Selling, General, & Administrative - GAAP | \$ 7,737 | \$ 7,895 | \$ 6,359 | \$ 5,990 | \$ 6,940 |
| Adjustment to reconcile GAAP SG&A to non-GAAP SG&A: | | | | | |
| Stock-based compensation expense | (1,085) | (1,004) | (917) | (925) | (734) |
| Expenses of arbitration (1) | (363) | (101) | — | — | — |
| Write-down in value of property and equipment | (162) | — | — | — | — |
| Selling, General, & Administrative - Non-GAAP | \$ 6,127 | \$ 6,790 | \$ 5,442 | \$ 5,065 | \$ 6,206 |

(1) Represents the expenses related to an arbitration proceeding over a disputed contract with a customer, which expenses are expected to continue until the arbitration is resolved.