



2019 Q3
Management Report

October 31, 2019



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The following commentary is provided by management and should be referenced in conjunction with PDF Solutions' third quarter for fiscal year 2019 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 Third Fiscal Quarter Results

Q3 2019 Key Metrics

Revenue: \$21.9M

GAAP Gross margin: 60%

Non-GAAP Gross margin: 64%

GAAP EPS: (\$0.02)

Non-GAAP EPS: \$0.05

Operating Cash Flow: \$18.0M

Capital Expenditures: \$2.8M

FINANCIAL RESULTS SUMMARY

- Total revenues for the third fiscal quarter of 2019 were \$21.9 million, up 6% from \$20.6 million for the second fiscal quarter of 2019.
- Solutions revenue for the third fiscal quarter of 2019 was \$16.2 million, up 21% from \$13.4 million for the second fiscal quarter of 2019.
- Gainshare performance incentives revenue for the third fiscal quarter of 2019 was \$5.7 million, down 20% from \$7.1 million for the second fiscal quarter of 2019.

Revenue Detail – Quarterly Q3 2018 Through Q3 2019

Revenue by Type

	<u>Q3'18</u>	<u>Q4'18</u>	<u>Q1'19</u>	<u>Q2'19</u>	<u>Q3'19</u>
Solutions Revenue	\$13,976	\$12,650	\$16,661	\$13,429	\$16,208
% of Total	69%	64%	81%	65%	74%
Gainshare performance	\$6,237	\$7,075	\$3,880	\$7,139	\$5,706
% of Total	31%	36%	19%	35%	26%
Total revenues	\$20,213	\$19,725	\$20,541	\$20,568	\$21,914
GAAP Gross Margin	47%	51%	62%	62%	60%
Non-GAAP Gross Margin	52%	55%	67%	67%	64%

Revenue by Geography

	<u>Q3'18</u>	<u>Q4'18</u>	<u>Q1'19</u>	<u>Q2'19</u>	<u>Q3'19</u>
North America (US/Canada)	\$8.4M	\$6.8M	\$9.3M	\$8.7M	\$7.4M
% of Total	41%	34%	45%	42%	34%
Europe	\$2.8M	\$3.1M	\$3.6M	\$3.1M	\$3.3M
% of Total	14%	16%	18%	15%	15%
APAC	\$9.0M	\$9.8M	\$7.6M	\$8.8M	\$11.2M
% of Total	44%	50%	37%	43%	51%
Total revenues	\$20.2M	\$19.7M	\$20.5M	\$20.6M	\$21.9M

Key Financial & Operating Metrics - Quarterly Q3 2018 Through Q3 2019

Key Financial & Operating Metrics

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

	<u>Q3'18</u>	<u>Q4'18</u>	<u>Q1'19</u>	<u>Q2'19</u>	<u>Q3'19</u>
Revenue	\$20,213	\$19,725	\$20,541	\$20,568	\$21,914
GAAP Gross Margin	47%	51%	62%	62%	60%
Non-GAAP Gross Margin	52%	55%	67%	67%	64%
Outstanding Debt	\$0	\$0	\$0	\$0	\$0
Operating Cash Flow	(\$676)	\$4,295	(\$151)	\$5,117	\$18,045
Capital Expenditures (CAPEX)	\$3,937	\$4,369	\$2,357	\$1,697	\$2,837
\$ Shares Repurchased	\$0	\$0	\$3,916	\$3,790	\$1,932
Days Sales Outstanding (DSO)	135	135	150	172	101
Weighted Average Common Shares Outstanding	32.2	32.3	32.5	32.3	32.4
Effective Tax Rate	21%	11%	4%	54%	43%

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 exclude the effects of non-recurring items (including adjustment to contingent consideration related to acquisition, restructuring charges and severance payments), stock-based compensation expenses, amortization of acquired technology and other acquired intangible assets, and their related income tax effects, as applicable, as well as adjusts for the non-cash portion of income taxes. 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)

	<u>Q3'18</u>	<u>Q4'18</u>	<u>Q1'19</u>	<u>Q2'19</u>	<u>Q3'19</u>
GAAP net loss	\$ (2,082)	\$ (3,114)	\$ (2,691)	\$ (710)	\$ (687)
Adjustments to reconcile GAAP net loss to non-GAAP net income (loss):					
Stock-based compensation expense	2,268	2,470	3,476	2,434	2,732
Amortization of acquired technology	144	144	144	143	144
Amortization of other acquired intangible assets	108	109	108	154	174
Restructuring charges and severance payment	48	576	92	—	—
Write-down in value of property and equipment	—	227	—	—	—
Adjustment to contingent consideration related to acquisition	—	90	—	—	30
Tax impact of adjustments	(281)	(868)	(287)	(993)	(805)
Non-GAAP net income (loss)	<u>\$ 205</u>	<u>\$ (366)</u>	<u>\$ 842</u>	<u>\$ 1,028</u>	<u>\$ 1,588</u>
GAAP net loss per diluted share	<u>\$ (0.06)</u>	<u>\$ (0.10)</u>	<u>\$ (0.08)</u>	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>
Non-GAAP net income (loss) per diluted share	<u>\$ 0.01</u>	<u>\$ (0.01)</u>	<u>\$ 0.03</u>	<u>\$ 0.03</u>	<u>\$ 0.05</u>
Shares used in diluted shares calculation	<u>32,385</u>	<u>32,476</u>	<u>33,022</u>	<u>33,055</u>	<u>32,997</u>

Reconciliation of GAAP to Non-GAAP Spending by Function

(in thousands)

	<u>Q3'18</u>	<u>Q4'18</u>	<u>Q1'19</u>	<u>Q2'19</u>	<u>Q3'19</u>
Cost of Solutions - GAAP	\$ 10,683	\$ 9,721	\$ 7,867	\$ 7,832	\$ 8,715
Adjustments to reconcile GAAP Cost of Solutions to non-GAAP Cost of Solutions:					
Stock-based compensation expense	(787)	(786)	(860)	(799)	(745)
Amortization of acquired technology	(144)	(144)	(144)	(143)	(144)
Severance payments	(48)	—	—	—	—
Cost of Solutions - Non-GAAP	\$ 9,705	\$ 8,791	\$ 6,863	\$ 6,890	\$ 7,826
Research & Development - GAAP	\$ 6,755	\$ 6,898	\$ 8,246	\$ 7,312	\$ 8,435
Adjustments to reconcile GAAP R&D to non-GAAP R&D:					
Stock-based compensation expense	(725)	(811)	(1,718)	(901)	(1,062)
Write-down in value of property and equipment	—	(227)	—	—	—
Adjustment to contingent consideration related to acquisition	—	(90)	—	—	(30)
Research & Development - Non-GAAP	\$ 6,030	\$ 5,770	\$ 6,528	\$ 6,411	\$ 7,343
Selling, General, & Administrative - GAAP	\$ 5,507	\$ 6,133	\$ 7,011	\$ 6,940	\$ 5,990
Adjustment to reconcile GAAP SG&A to non-GAAP SG&A:					
Stock-based compensation expense	(756)	(873)	(898)	(734)	(925)
Selling, General, & Administrative - Non-GAAP	\$ 4,751	\$ 5,260	\$ 6,113	\$ 6,206	\$ 5,065