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PRESENTATION

Operator

Good afternoon and welcome to Adesto Technologies Second Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. At the conclusion of today's conference call, instructions will be given for the question and answer session. As a reminder, this conference call is being recorded today, August 6, 2019.

I would now like to turn the call over to Joel Achramowicz of Shelton Group Investor Relations. Joel, please go ahead.

Joel Achramowicz

Thank you, Sarah. Good afternoon everyone, and welcome to Adesto Technologies second quarter 2019 earnings conference call. I'm Joel Achramowicz, Managing Director at Shelton Group, Adesto's Investor Relations firm. Joining me today are Narbeh Derhacobian, Adesto's President and CEO, and Ron Shelton, the company's Chief Financial Officer.

Before I turn the call over to Narbeh, I'd like to remind our listeners that during the course of this conference call the company will provide financial guidance, projections, comments and other forward-looking statements regarding future market developments, the future financial performance of the company, new products or other matters. These statements are subject to the risks and uncertainties that we discuss in detail in our documents filed with the SEC, specifically the final prospectus related to our initial public offering, our 10-K, and our most recent 10-Q, which identify important risk factors that could cause actual results to differ materially from those contained in the forward-looking statements.

Also, the company's press release and management statements during the conference call will include discussions of certain non-GAAP financial measures. These financial measures and related GAAP to non-GAAP reconciliations are provided in the company's press release and related current report on Form 8-K, which can be found in the Investor Relations section of Adesto's website at www.adestotech.com. For those of you unable to listen to the entire call at this time, a recording will be available via webcast on the company's website.

And now, it's my pleasure to turn the call over to Adesto's President and CEO, Narbeh Derhacobian. Narbeh?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Thank you, Joel. Welcome to everyone joining us today. Second quarter revenue set a quarterly record at $30.2 million and was above the midpoint of our guidance, increasing 66% year-over-year. More importantly, all of our divisions recorded year-over-year growth, and we expect this trend to continue in the second half.

Second quarter revenue grew 7.3% sequentially and our first half of 2019 revenue was up almost 75% compared to the same period last year, reflecting continued strong organic growth combined with increasing revenue and margin contribution from both our ASIC and embedded systems divisions.

Moreover, with our strong growth and our focus on managing operating costs, we significantly increased adjusted EBITDA, moving closer

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to our goal of non-GAAP profitability, and we generated positive free cash flow as well.

Looking at our second quarter revenue in more detail, our top 20 customers represented approximately 52% of the total revenue, while the remaining 48% of revenue was distributed across approximately 5,000 end customers. In terms of end segments, industrial represented approximately 48% of total revenue for the quarter and consumer and computing represented 45%, with the remaining 7% of our revenue spread across communications, medical, and other end markets.

We saw sequential growth across both industrial and consumer segments, with the consumer business showing double digit growth over Q1 driven by our memory business. With solid growth projected across these two segments and favorable mix for our products, we expect second half gross margins to trend upwards.

Before I dive into the operational details, I'd like to speak briefly about a recent announcement. Last week we appointed two new board members to our Board of Directors. Since we have made Industry 4.0 a strategic focus for the company, Adesto's board decided to bring on seasoned executives from this segment to augment our current Board of Directors.

Both Susan Uthayakumar and Herve Fages are accomplished executives, having managed significant businesses in tier 1 global companies including Honeywell and Schneider Electric. They both bring deep domain expertise and strategic vision from tier 1 industrial companies, and we are confident that they will significantly enrich our view of how to best serve our industrial customers.

Now I'll review some of the recent developments from across the company. As our largest served market, we continue to focus on the industrial segment and address the challenges facing our customers in transitioning to Industry 4.0. During Q2, we made significant progress with two new products specifically targeting this segment.

SmartServer IoT is a truly open multi-protocol edge server that's purpose-built for building automation and industrial deployments. SmartServer IoT is specifically designed to ease the arduous task of integrating legacy industrial fleet protocols such as Lon, BACnet, and Modbus to emerging IoT and IP-based protocols. This is a Linux based platform based on a modern web services architecture that's designed specifically to make it easy to connect to cloud platforms for deeper business insights and predictive analytics.

During the quarter, we officially released the first customer samples, and in the first half more than 10 distinct customers have already purchased evaluation development kits. Our go-to-market approach consists of 2 main avenues; first, transitioning existing customers who in the past have used Echelon's old server, and second, engaging with new customers in new markets using a variety of partners.

We have already begun shipping the SmartServer IoT to several new customers for pilot programs in building automation and smart city deployments. The smart city application is particularly interesting, as one particular customer has pilots running in several cities. The end solution is a customizable smart pole that acts as a node for cellular 4G or 5G, Wi-Fi, LED Beacon, CCTV, and Environmental sensors, along with options for fiber connectivity down below.

We have built a strong pipeline at the end of Q2 for our SmartServer IoT, and we estimate measurable revenue contribution to start in the next 12 to 18 months. We also expect to build on this and expand the pipeline as the year progresses.

Later this week, we will share news about another new product that's ideal for Industry 4.0 applications. Our latest transceiver chip, the FT 6050, now provides more interoperability to aid integration of complex industrial network deployments. This smart transceiver system-on-chip now natively supports LON®, LON/IP, BACnet/IP, and BACnet® MS/TP protocol stacks, uniquely enabling the popular LON and BACnet industrial protocols to communicate simultaneously over highly reliable and widely adopted free topology networks.

LON and BACnet together constitute over 70% of the protocols used in building automation, where often integrators have the need to incorporate both protocols in a network for an integrated deployment. FT 6050 is designed to help reduce the cost of integration for these industrial deployments with its built in full protocol stacks for LON, LON/IP, and BACnet IP.

During the quarter, we sampled various customers in HVAC control, indoor lighting, transportation, refrigeration control, amongst

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others. The pipeline for FT 6050 looks robust and growing, and we expect to start generating revenue from this new release starting in 12 months.

Together, SmartServer IoT and FT 6050 address a market opportunity of over $20 million per year and form the cornerstone for solidifying and broadening our position in the industrial segment, in which we expect to have a sustainable and defensible revenue growth of 15% per year over the long-term.

Our memory division also made significant gains in the industrial segment in the second quarter. We had more than a dozen new design wins with a new industrial customer, especially in Europe, on the DataFlash memory family. Applications included smart grid as well as industrial control. We continued to secure wins with our existing smart meter customers in Asia as well as with our top metering customers in Europe and North America.

Advanced samples of our new FusionHD 32 megabit device were also sampled by some of our existing metering customers for new gas and water meter platforms. More importantly, we have also begun sampling our EcoXiP 128 megabit device with a leading industrial customer for residential sensor applications.

Now let's turn to our consumer business. Our consumer business grew double digits sequentially in the second quarter, primarily driven by our memory division's major tier 1 customer. In the second quarter, we secured multiple new design wins with this customer for our standard Flash, DataFlash, and Fusion family memory products.

We expect these new design wins to turn into mass production revenue within the next 9 to 12 months. The end applications for these wins include IOT personal devices as well as portable computing applications.

In the previous earnings call, we had mentioned our large meaningful EcoXiP design win with a leading fitness tracker company. So far, indications are that this customer will begin ramping production late this year, with the bulk of the ramp occurring in 2020. We have also begun engaging with this customer with our new higher density EcoXiP 64 megabit for added opportunities.

In general, the EcoXiP pipeline continues to build momentum with robust sampling activities in the customer segments driven by a need for high performance edge computing while maintaining low power consumption.

In other consumer applications, our ASIC team continued to deliver on project milestones to several customers. Notable active ASIC projects in this space included a human-machine interface application, as well as an ASIC related to wearable augmented reality products. This latter program is also a perfect example of opportunity synergy for Adesto, as the customer has chosen EcoXiP as the companion memory for ASIC, awarding Adesto more share of the wallet.

Finally, I'd like to discuss our opportunities within the communications market. Along with several active ASIC projects ongoing now, we have completed and delivered 2 ASIC projects to 2 communications customers in the last 9 months, one in the satellite communication application and the other in the cellular area. We have contracts to deliver ASIC units to these two customers when they ramp into production.

The satellite communication customer has started to place production orders. And we expect the cellular customer to start placing orders late this year, with the ramp occurring in the second half of next year. The cellular end application for this opportunity is to deliver multi-hundred megabits per second to gigabit per second non-line-of-site broadband access over several kilometers.

Our ASIC is qualified and ready to go. According to our customer, their field trials are going better than expected, and several service providers are very excited about that technology. We believe this particular project could represent a sustained recurring unit revenue for us in the coming years.

As is evident in my comments today, a great deal of activity infused with excitement is underway at Adesto. Driven by our execution and a new transformed Adesto, we continue to see expanded opportunities. We believe that the second half will continue to present itself with

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more growth drivers for Adesto's future as the company continues its drive to provide a broad value-added stack of technologies for IOT applications across our targeted segments.

Now let me turn the call over to Ron to review the second quarter financial results and our third quarter guidance before opening the call for your questions. Ron?

Ronald K. Shelton ***Adesto Technologies Corporation - CFO***

Thanks, Narbeh, and thanks everyone for joining us today. As I've done in prior quarter reviews, I'll focus my discussion today on non-GAAP financial results and refer you to today's press release for a detailed description of our GAAP results, as well as the reconciliation of GAAP to non-GAAP financial results. Non-GAAP adjustments relate to stock-based compensation, purchase accounting adjustments, earn-out adjustments, debt amortization and impairment and other charges.

Now let's go through the results. Revenue for the second quarter was a record $30.2 million. That's an increase of approximately 66% over the $18.2 million in the second quarter of 2018, and up 7.3% sequentially as we continue to see positive product and customer momentum in all areas of the business.

Non-GAAP gross margin in the second quarter was 48.1%. That's compared to 43% in the second quarter of 2018 and 49.4% in the prior quarter. As I've stated in the past, our gross margins may fluctuate from quarter to quarter, and that's mainly due to product mix. But as our third quarter guidance indicates, we continue to advance toward a target model of 50% to 55%.

Non-GAAP operating expenses in the second quarter of 2019 were $14.3 million. That's compared $8.3 million during the second quarter of 2018 and $14.4 million in the prior quarter. As we've noted in the past, we believe there is tremendous leverage in our operating model, and our results this quarter support that.

In addition, based on our guidance for the third quarter, our sequential growth rate in revenue will comfortably exceed that of our operating expense growth rate, contributing to what is expected to be higher adjusted EBITDA in the third quarter.

Total other expense in the second quarter was about $1.4 million. That's almost entirely consisting of interest expense.

On a non-GAAP basis, net loss was $0.7 million or $0.03 per share, compared to a net loss of $1.6 million or $0.08 per share in the second quarter of 2018 and a net loss of $1.6 million or $0.05 per share in the prior quarter. Non-GAAP adjustments to net income in the second quarter included $1.8 million of amortization of intangible assets, $1.4 million of stock-based compensation expense, and $400,000 of debt amortization costs. For the second quarter of 2019, our diluted share count was 29.7 million shares.

Now turning to the balance sheet, we ended the quarter with cash, cash equivalents, short-term investments, and restricted cash of $7.7 million. Our adjusted EBITDA continued to expand to approximately $880,000 in the quarter, and we remain on track for adjusted EBITDA margins to exceed 10% of revenue by the end of the year.

In addition, we continue to manage the balance sheet very well. Net accounts receivable was $24 million and DSOs were down to 57 days, which I expect to continue to decline going forward. Net inventory declined by almost $2 million, or 11%, to $14.8 million as we remain focused on and continue to execute to our targeted inventory turns of a minimum of 4 times. And we expect to reach those levels by the end of this year. The net impact of a higher adjusted EBITDA and exceptional balance sheet management resulted in positive free cash flow for the quarter.

With regards to our capital structure, we've communicated in the past that we would supplement existing cash balances with expanded credit facilities. While not yet closed, our expectation is that in the near future we will put in place such expanded credit facilities, and expect the amount will be as much as $12 million.

Given our outlook in the business in terms of revenue growth and profitability, our view is that this is the most shareholder friendly way of moving forward, as there is no desire on the part of management or the Board to raise equity at these share price levels.

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Together with our existing cash balances and our expectation that adjusted EBITDA margins will exceed 10% by the end of the year, we expect that we'll have capital available (without the need to raise additional equity capital) that is sufficient to fund the growth we currently see in the business.

Now for a couple of housekeeping items, as I mentioned earlier, adjusted EBITDA for the second quarter of 2019 was a positive $0.9 million. That's compared to a positive $0.1 million during the second quarter of 2018 and a positive $12,000 in the prior quarter. Capital expenditures were $700,000 for the quarter, and depreciation and amortization was also about $700,000.

Now let me turn to guidance for the third quarter of 2019. We expect revenues to increase to a range of $31.5 million to $34.5 million, which at the midpoint represents an increase of more than 9% sequentially and over 50% year-over-year. This guidance puts us on track for revenue to grow more than 15% in the second half of 2019 when compared to the first half of 2019.

Non-GAAP gross margin for the third quarter is expected to range between 50% and 52%, as we remain on track to achieve our goal of sustainable gross margins above 50%. Non-GAAP operating expenses are expected to range between $14.5 million and $15.5 million, and we currently expect they'll remain relatively flat at those levels through the rest of the year.

Stock-based compensation in the third quarter will be approximately $1.7 million. Amortization of intangible assets will be approximately $1.8 million, and depreciation and amortization will be approximately $900,000.

Interest expense is expected to be approximately $1.5 million, and weighted average shares outstanding are anticipated to be approximately 30.1 million shares.

So lastly in my closing comments, I'd like to summarize and highlight some of the various points we've made in our commentary. First, we see continued revenue growth in the business, with a strong second half driving revenue at least 15% higher than the first half. And our view is that this is a much higher growth rate than the industry in general.

Our gross margins are expanding to more than 50%, and that demonstrates that our businesses are coalescing around a common strategy. We have a continued laser-like focus and execution on spending, where we invest for growth in initiatives that are supporting our long-term model. Adjusted EBITDA margins are trending towards more than 10%, and they will reach that level by the end of the year. And we have a capital structure in place that is sufficient to support our growth.

It was a really good quarter, and the business is set up to deliver even better results in the second half of the year. So with that, we'll open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Raji Gill from Needham & Company.

Rajvindra S. Gill ***Needham & Company, LLC, Research Division - Senior Analyst***

Congrats on really good results. On the industrial segment, you mentioned kind of two new products on the SmartServer IoT and then the Smart Transceiver chip. I was wondering if you could elaborate on the go-to-market strategy. So your ability to transition existing Echelon old servers to the new product, can you maybe elaborate further on how that's kind of tracking and what the process is to do that? And with respect to kind of your position in smart city and building automation, you had mentioned about a $20 million opportunity, I guess, for both products. Maybe you could elaborate further on the $20 million opportunity, how we get to that number in terms of maybe units or ASPs.

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Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Sure, Raji. Hi, it's Narbeh. So with respect to go-to-market strategy with SmartServer IoT, I indicated it's a two-pronged approach. So one is obviously converting existing customers. And our existing customers, if you think about it, there is a run rate business in the background for the old Echelon server. That -- we are taking some actions with respect to engagement with the customers and pricing strategies to basically force the transition to occur.

Now as you know, being an industrial market and being such a technically engaged solution as a smart server, these are very sticky sockets. So basically customers do have the -- it's to their best interest to transition into a platform that they are familiar with. And the SmartServer IoT is backward compatible, so it allows them a very smooth transition and creates a roadmap for them for further expansion.

More importantly, they're also looking to enhance their networks to be able to get the data out into the cloud providers and bring in some more business intelligence in the business. So it's a win-win situation for everyone.

In terms of the -- okay, sorry. The second approach we're taking is with respect to some of the new partnerships we've formed and some existing ones to drive feeding the market with the smart server. One is we reported last quarter -- about two quarters ago about the partnership we have with IBM Watson IoT program to be able to go jointly with IBM and use that channel as a way for us to expand into markets that we haven't been into.

And second is that we're working with a large number of integrators who really like the SmartServer IoT because it basically helps their integration job because it's in a much efficient and lower cost way. So we're using those two partners as go-to-market for the SmartServer IoT.

In terms of the number, the way to think about it is that the ASPs for a SmartServer IoT ranges anywhere between $600, $700 all the way to over $1,000. And in some cases, there is services and subscriptions and node keys that are attached to a particular sell opportunity that gives us a large degree of freedom to help construct a model that our customers would prefer and also would help drive the growth in the business.

On an annualized basis, our expectation is that 10,000 to 15,000 smart servers per year is not an unusual run rate for our business. And if you think about the number I quoted, it does not include some of the new revenue attachment models that I indicated in the past that we'll be rolling out next year. So I believe that the number I quoted is actually a conservative number, but that's the number that we're comfortable discussing right now.

Rajvindra S. Gill ***Needham & Company, LLC, Research Division - Senior Analyst***

Okay, that's really helpful to try to quantify it. And Ron, in terms of the cost synergies, I think on the last quarter you had mentioned that you're going -- if I remember, you're going to realize I think $1 million to $2 million cost synergies in the second half from the sale of the lighting business. Is that still kind of on track?

Ronald K. Shelton ***Adesto Technologies Corporation - CFO***

Yes. If you saw OpEx, I mean, I think it was down a little bit this quarter. So it's ticking up a little next quarter. And I think what we're doing -- well, not I think. I mean, we've seen those -- we're seeing those cost synergies. The lighting business is almost completely wound down now.

But we will invest, and that's why you're seeing a little bit of an uptick in R&D this quarter of investing in the business. I think there is tremendous opportunities, as Narbeh has talked about, in recurring revenue streams. And I think we want to see that accelerate, so we're making some investments in those areas.

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Rajvindra S. Gill ***Needham & Company, LLC, Research Division - Senior Analyst***

Okay. And last question on the gross margin. So the gross margin for the guidance kind of broke above 50%, 51%. And I guess how do we -- best we can, how do we think about the gross margins quarter by quarter? Is the seasonality in the Echelon and S3 greater in certain quarters and therefore there's going to be a greater margin -- positive margin impact, or is it not necessarily seasonal in terms of modeling quarter by quarter?

Ronald K. Shelton ***Adesto Technologies Corporation - CFO***

Yes. That's a good question. I don't know that it's seasonal. I think there are a couple things happening right now. I think as S3 and -- or the ASIC business and the embedded business, they've been fully integrated for the most part at this point. We're seeing incremental margin benefits from doing that. So we're seeing higher margins in those businesses.

The memory business is pretty consistent in terms of those margins. And if you recall, we target those for somewhere in the low to mid 40%s, and I think that model is holding together. So we targeted 50% to 55% as the long term model, where outlook to midpoint for Q3 is 51%. Our expectation is the second half will be 50% or better overall. And that's kind of how it's positioned going forward into next year.

So I don't -- if anything, I think you tend to have some consumer drop-off in Q1 which might be more weighted towards memory. But I wouldn't think about it in that context. It's probably a little too granular. I think we're at the low end of that 50% to 55% right now.

Rajvindra S. Gill ***Needham & Company, LLC, Research Division - Senior Analyst***

Okay, great. Congrats on excellent momentum. Thank you.

Ronald K. Shelton ***Adesto Technologies Corporation - CFO***

Thank you.

Operator

Your next question comes from the line of Mike Walkley of Canaccord Genuity.

Anthony Nemoto ***Canaccord Genuity LLC, Research Division - Associate Analyst***

This is actually Anthony on for Mike. In terms of the pipeline for ASIC projects, I was wondering if you could provide additional color on kind of the size of the opportunities. I think previously at one point you had mentioned targeting up to the $3 million range in terms of annual opportunity size. When do you think -- well, firstly, are you seeing kind of those kind of sizes of opportunities? And then when do you think we'll start to see that layering effect? Is that more of a 2020 type timeframe when that'll come through?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Yes. So on the ASIC, again, the revenue components for the ASIC business is primarily twofold -- it's actually threefold. But if you look at it, first is in the ASIC itself is the NRE. So this is basically a contractual agreement to design and deliver to the customer a qualified chip. Then after that, as the customer takes the product, incorporates it in its system and then goes into a mass production, its contractual obligation is for the customer to purchase the chip through us.

And that second piece becomes a recurring revenue for the business. Essentially, imagine all the R&D is done and it's primarily an operational activity for us to supply the customer.

Now, what I indicated today was that two such completed projects have been given to the customer in the past nine months. And I had said earlier that we were expecting these to go into production late this year. And I indicated this time that one of these customers in the satellite communication market has already started to place orders for the product with us in terms of the units.

The second one, which is a much bigger volume opportunity in the cellular space, we've delivered a chip to the customer. It's been qualified. Now the customer is going through their own system design and with their end customers, which are basically service providers.

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They have a pilot program running in multiple cities. And the pilot programs have been -- I just met with the customer a couple of weeks ago. The pilot program has been better than they expected. We are expecting some volume from that late this year. But the bulk of the volume is going to happen in the second half of next year as they start to ramp.

Now, at any given time, our ASIC group is able to do 4 to 6 ASIC projects. So the revenue coming in from the ASIC business on a quarter basis consists of this NRE revenue plus any of the unit revenue. And today it's fair to say the unit revenue is minuscule because none of the chips we've delivered, the customers have gone into production. But as we enter 2020 and especially second half of 2020, we'll start this -- you'll start to see this grow.

By the way, I just want to make one more comment. Of all of our divisions, of course coming off of a smaller base, our ASIC division has had the fastest growth year-over-year. And this is basically indication of, as I said last time, their pipeline has increased because of our channel, and then some of these customers are beginning to go into production. So I expect that trend to continue into next year and that division to be our fastest growing division internally.

Operator

Your next question comes from the line of Karl Ackerman with Cowen & Company.

Karl Fredrick Ackerman ***Cowen and Company, LLC, Research Division - Director & Senior Research Analyst***

I wanted to focus first in your memory business. It would appear that that business has held up a little bit better than certainly peers that have reported so far for Q2. And so I guess I'd love to get your view on ASPs and perhaps industry dynamics there from a bits and ASP perspective. And then more specifically, are you seeing some benefit from an uplift in connectivity and smart home assets like others in the supply chain have seen, both this quarter and also as they look into the September quarter?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Yes. So generally speaking, again, historically even if you go back several years, when people react to memory business, whether it's the cyclical nature, whether it's supply and demand dynamics driving ASPs, I've always indicated that the business that we are in is usually less prone to those sort of fluctuations because we are selling application specific memory mostly.

Our gross margins indicate that these are more value-added products selling into sticky sockets. And also we don't compete in end markets necessarily that have these big volume and supply and demand fluctuations such as mobile handset markets or personal computing markets heavily. We sell typically into what we call IoT markets or embedded systems markets, and it's very much spread out across the different segments.

And also, lastly, because of the densities of memories that we have in our portfolio, typically low to mid density, the year-over-year ASP degradation that's very typical of the bleeding edge memory, we don't see that because there is no new supply necessarily coming online to offset that balance. Typically we see from a price degradation anywhere in low single digit percent year-over-year, and we are always able to manage that by our own cost reductions with our back end.

And your second question is -- so, this is just part of your first question in terms of we didn't see that in the Q2. We saw an uplift for us on the memory side. Now, you also indicated about the smart home application, yes.

So in smart home, we have -- definitely we play in that in smart connected lighting. This was a business that we were pretty excited about about a year and a half, two years ago. Then it went relatively quiet for us. We had high hopes for that ramp to occur sort of mid last year, but we're beginning to see that particular ramp occur now. So we are seeing that.

And then also, we had the DataFlash-L product that, if you remember, last year we had brought out. It was ramping very fast, but then it went -- second half of last year started to really slow down and didn't experience any growth. This quarter we also saw growth in that particular product line, which is primarily targeted in the smart home market. So we do see that uplift as well in our business on the smart home side.

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Karl Fredrick Ackerman ***Cowen and Company, LLC, Research Division - Director & Senior Research Analyst***

That's helpful. I guess Ron and Narbeh, could you discuss how your sales channels are evolving now that you offer a much larger portfolio of products and services? And Ron, you indicated that you were funneling some of the savings from past restructuring actions back into the business as you drive growth here. But I guess how do I think about that from perhaps an OpEx side and/or a sales channel side with regard to go-to-market as you contemplate some of the growth opportunities, both in the second half of this year and into 2020?

Ronald K. Shelton ***Adesto Technologies Corporation - CFO***

Yes, let me talk about the reinvestment. I think if you go back a year ago, I mean, we talked about taking certain costs out of the Echelon business, and we've done that. We've done that pretty well. We're seeing a little bit of an uptick in spending this quarter.

And again, when you think about that business in particular and the ASIC business, they're very high margin businesses. There are numerous opportunities, we think, especially on the embedded side with recurring revenue sources, where we think it's important to invest in that now.

Again, we're seeing expanding margins in both of those businesses today, so I think we're being judicious in terms of how we invest the money and where we invest the money. And I think we're literally seeing the returns on that in the near term. This isn't something where we're waiting a year or two years or three years. We're seeing it right now.

With respect to the go-to-market strategy, I'll let Narbeh touch on that.

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Yes. So we've done a few things in terms of integrating the channel. So one is we have now -- we've basically pruned and consolidated our distribution network. In terms of our rep networks, we have rolled out incentive programs.

First of all, we've introduced a new product portfolio, technologies we have for the rep networks to go out and seek opportunities for us. So we have trained the rep network throughout the year in terms of where to seek those opportunities, and also put in an incentive program for the network to go and bring opportunities to us.

And as you can imagine, an ASIC opportunity, which is a more complicated sell as compared to selling a memory device, will take a little bit of a different structure, different approach, different time to close within the channel itself. So we've sort of taken that into account on how we rolled out the new incentive program.

And then with respect to our internal sales force, we again have created a structure where it's encouraging cross-fertilization and cross-selling opportunities. And we are beginning to see fruits of that in looking at the pipeline growing across the different divisions as teams are bringing opportunities in.

And there are some tangible measures, like I indicated today in the call, where an ASIC opportunity has actually turned also into an EcoXiP opportunity. And those sort of things we'll start to see a lot more in the future.

Operator

Your next question comes from the line of Sujeeva De Silva from ROTH Capital.

Sujeeva Desilva ***Roth Capital Partners, LLC, Research Division - Senior Research Analyst***

Congratulations on the progress here. Ron, if I take your guidance here for the third and fourth quarter, it implies sequential growth both quarters. I'm wondering if there's any segment that's relatively stronger or if they're all growing relatively equally, and if the fourth quarter has any seasonality or it would be secular strength in the fourth quarter.

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Ronald K. Shelton ***Adesto Technologies Corporation - CFO***

So everything's growing, and they're all growing strongly. I think -- so there's no single segment or anything that's going to be growing faster than the others. And you can get a sense for where we're guiding gross margins that that's the case.

I think in terms of kind of how the rest of the year breaks out, it'll be -- Q4 will be higher than Q3. So we've guided midpoint around $33 million for Q3, and we expect Q4 would be higher.

Sujeeva Desilva ***Roth Capital Partners, LLC, Research Division - Senior Research Analyst***

And then specifically on the smart meter end market, I'm wondering if there is any lumpiness to the strength you're seeing there, or whether that's a sustained sort of growth trajectory for the next several quarters.

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Historically, that's been a strong segment and sub-segment for us in general with respect to our memory and power line communication devices. And because we have a fairly good position with multiple meter vendors and then also a good position in terms of electricity, gas, and water meters, I think we are very much immune to any particular customer or particular segment fluctuation.

What I will say, though, is that we do see an uplift in the meter business not necessarily coming from tier 1 meter companies, which they are our customers, but also tier 2 meter customers, especially in Europe and especially in eastern Europe. So that's something that I highlighted also on the call, especially with respect to the new industrial business that we had wins with in this quarter.

Sujeeva Desilva ***Roth Capital Partners, LLC, Research Division - Senior Research Analyst***

And then lastly, Ron, can you talk about the earn-out liability on the balance sheet and what the expected timing and magnitude of that bill would be? And can you remind us the funding plan to support that?

Ronald K. Shelton ***Adesto Technologies Corporation - CFO***

Sure. So on the face of the balance sheet, there's $10.1 million. I think that payout is -- those came due, or the measurement periods were basically the March quarter. And so that process, there was a process in terms of negotiating and settling on what those are, and that's in process right now.

My expectation is whatever payouts needs to be made, will happen this year. And again, I think to supplement that, what we've talked about is incremental credit facilities. That plus our adjusted EBITDA margins have gone up quite a bit. So we feel pretty comfortable and confident about kind of where we are in terms of capital.

Operator

(Operator Instructions) Your next question comes from the line of Aman Gulani from B. Riley FBR.

Aman Raj Gulani ***B. Riley FBR, Inc., Research Division - Associate Analyst***

Can you talk a little bit about the opportunity with GCT Semiconductors? I get the feeling that that might be the communications opportunity that you mentioned might be ramping into fourth quarter. Just want to confirm that, and then if you could quantify that opportunity that would be helpful.

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Sure. Sure. No, it's not the same opportunity. The GCT opportunity is actually an IP licensing agreement. So our ASIC business, I indicated their three-pronged revenue mostly. One is ASIC projects that we design for the customer. One is ASIC units that we deliver to the customer. But also as we build or design chips for the customer, certain blocks of IP that we develop particularly for that customer that we develop doing that project is really ours to keep. And we usually look for opportunities to license those blocks in areas where it does fit as a one-time licensing play.

And this particular GCT opportunity that we had entered into this time was a licensing agreement. Again, it's related in terms of the space they play in. It's both cellular and 5G play. But the one that I mentioned, which is an ASIC -- a full turnkey ASIC project, this one is

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a project that we've delivered the design, already qualified, and the customer will be going into mass production and we'll be delivering unit volumes to the customer. There are two separate customers.

Aman Raj Gulani ***B. Riley FBR, Inc., Research Division - Associate Analyst***

And then just turning to the memory business, I know the MavriqCM opportunity is pretty small right now. But have you started shipping that to your camera module customer? And then also, are you actively looking to engage more camera module customers?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Yes, we have started shipping, although less than I had expected to ship where we are. Part of that, we're -- I think the message we get from the field is related to some of the tension that exists between the two countries, because our point was to go into second tier module markers, which are all in China. And we're getting some resistance from the second tier players to go out and acquire products from outside specifically U.S.

So that's created some resistance for us in terms of ramping. We are still looking at other, but we do have sort of a business in the background. It's small. But everything indicated today in terms of our growth and our outlook is not dependent on the camera module to be the -- to have a hockey stick sort of growth at all.

Aman Raj Gulani ***B. Riley FBR, Inc., Research Division - Associate Analyst***

Just one more question for me. You mentioned you captured more design wins with your large tier 1 customer. Is that sort of new products that they might be launching, or is that sort of the next generation product that they might be rolling out in the next year or so?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

It's both, actually. So we know we're engaged with next generation products of the same platform that we've been engaged with recently. But also, we have with different memories now, with DataFlash/Fusion, which are not our standard Flash, as well as standard, that we have some new design wins in that customer.

Aman Raj Gulani ***B. Riley FBR, Inc., Research Division - Associate Analyst***

So the prior designs with this customer were all for the standard product, but now you've captured some for your value-add products such as FusionHD.

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

It's not FusionHD. It's just regular Fusion, yes.

Operator

Your next question comes from the line of Gus Richard from Northland.

Auguste Philip Richard ***Northland Capital Markets, Research Division - MD & Senior Research Analyst***

On the ASIC business, can you give a little qualitative color on which pieces are growing the fastest, units, NRE, or the IP business?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

From a size perspective or from a percent perspective. So percent perspective is--.

Auguste Philip Richard ***Northland Capital Markets, Research Division - MD & Senior Research Analyst***

Both.

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Okay. So percent perspective, the IP business grew very -- was the highest growth last quarter. But if I look at the overall slide, sort of sustained growth is the ASIC business. And today most of the ASIC business are the projects that we're doing handing over to the customers.

The unit revenue is at this time -- is miniscule at this time, as I indicated. It's beginning to materialize as we enter next year.

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Auguste Philip Richard ***Northland Capital Markets, Research Division - MD & Senior Research Analyst***

And do you expect the IP business to help you out in terms of gross margin in the back half? Is that what's giving the lift, or is it more across all the products?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Yes. Yes. So overall, if I look at overall as a company, right, that IP business of course is in a -- it's a high gross margin. It does help. But from a total dollar perspective, it's not that significant in the sense that it overwhelms other businesses. So we expect the gross margin improvements overall to be broad across all the divisions.

Auguste Philip Richard ***Northland Capital Markets, Research Division - MD & Senior Research Analyst***

So memory, building automation, and ASIC should all see an uplift sequentially in the third and fourth -- or third quarter?

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Right.

Operator

I'm showing no further questions at this time. I will turn the call back over to Narbeh Derhacobian for closing comments.

Narbeh Derhacobian ***Adesto Technologies Corporation - Co-Founder, President, CEO & Director***

Thank you. Before closing the call, I'd like to let you know that we will be attending the Canaccord conference this coming Thursday, this week on August 8 in Boston, and the Jefferies Semiconductor, Hardware, and Communications conference in Chicago on August 27th. If you'd like to arrange a meeting with us at any of these events, please contact us at IR@adestotech.com, or the Shelton Group.

Thanks again for joining us today, and we look forward to discussing our continued progress on our next earnings call. Operator, you may now disconnect. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day. You may now disconnect.

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