

Q4 2018 Earnings Call

Company Participants

- Alexander Rogers, Executive Vice President & President, Qualcomm Technology Licensing
- Cristiano R. Amon, President
- Donald J. Rosenberg, Executive Vice President, General Counsel & Corporate Secretary
- George S. Davis, Executive Vice President and Chief Financial Officer
- John T. Sinnott, Vice President, Investor Relations
- Steven M. Mollenkopf, Chief Executive Officer & Director

Other Participants

- Amit Daryanani, Analyst
- Brett Simpson, Analyst
- Romit Jitendra Shah, Analyst
- Ross C. Seymore, Analyst
- Stacy Aaron Rasgon, Analyst
- T. Michael Walkley, Analyst
- Tal Liani, Analyst
- Timothy Arcuri, Analyst
- Timothy Patrick Long, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Qualcomm fourth quarter and fiscal 2018 earnings conference call. As a reminder, this conference is being recorded November 7, 2018. The playback number for today's call is 877-660-6853. International callers please dial 201-612-7415. The playback reservation number is 13684055.

I would now like to turn the call over to John Sinnott, Vice President of Investor Relations. Mr. Sinnott, please go ahead.

John T. Sinnott {BIO 20007481 <GO>}

Thank you and good afternoon, everyone. Today's call will include prepared remarks by Steve Mollenkopf and George Davis. In addition, Cristiano Amon, Alex Rogers, and Don

Rosenberg will join the question-and-answer session.

You can access our earnings release and a slide presentation that accompany this call on our Investor Relations website. In addition, this call is being webcast on qualcomm.com, and a replay will be available on our website later today.

During the call today, we will use non-GAAP financial measures as defined in Regulation G, and you can find the related reconciliations to GAAP on our website.

We will also make forward-looking statements, including projections and estimates of future events, business or industry trends, or business or financial results. Actual events or results could differ materially from those projected in our forward-looking statements. Please refer to our SEC filings, including our most recent 10-K, which contain important factors that could cause actual results to differ materially from the forward-looking statements.

And now to comments from Qualcomm's Chief Executive Officer, Steve Mollenkopf, who is speaking from our offices in China.

Steven M. Mollenkopf {BIO 16172191 <GO>}

Thank you, John, and good afternoon, everyone.

We are pleased to report a strong set of results this quarter, as we continued to execute on our strategic priorities to drive technology and product leadership, particularly in 5G, manage our operating expenses, and return capital to our stockholders.

Fiscal 2018 was an extraordinary year in the history of Qualcomm. We successfully navigated through many challenges, yet remained focused on execution and the significant opportunities in front of us. I believe we enter fiscal 2019 a stronger company and extremely well-positioned for the future. Our fiscal fourth quarter results reflect continued strong performance, with non-GAAP earnings of \$0.90 per share, \$0.05 above the high end of our guidance range, reflecting better than expected QCT performance and lower operating expenses.

The growth of our leading customers in China was a positive for the company in the fiscal fourth quarter, both on volume and improving mix of devices. We expect further growth from our China business in fiscal 2019, particularly in the second half of the fiscal year. The combined impact of Apple instructing their contract manufacturers to stop paying their contracted royalty payments and Apple's decision to use a competitor's modem for their latest device has had a significant impact to our financial performance. Notably, over 50% of the expected fiscal 2019 headwind related to Apple is reflected in our first fiscal quarter guidance and impacts our QCT business. As we progress through the year, this will become less impactful to our quarterly results.

FINAL

Despite this, as you can see from our results, we are continuing to execute well with our customers. Importantly, we've laid a strong foundation for growth as we differentiate through our industry-leading innovation ahead of some very big opportunities, including the launch of 3G (sic) [5G] (4:00), the ramp of our RF front-end business, as well as industry transitions in Wi-Fi and the connected car.

Looking ahead to fiscal 2019, the entire company remains focused around these three key priorities. Priority number one is to drive the transition to 5G. When the world is introduced to 5G early next year, we believe we will be the technology partner in nearly all the commercial launches around the world. This position is no small accomplishment. Transitions in wireless like 3G, 4G, and 5G are unforgiving to companies and competitors that are late to these transitions, especially in the initial ramp years. Our focus and investment priorities over the last couple of years have enabled us to successfully establish a strong technology position and lead the 5G industry transition, which will represent a significant opportunity for Qualcomm to expand revenue and earnings as we exit fiscal 2019.

Just as 5G launch dates were accelerated by one year from the original timeline, we also expect the pace of 5G adoption to meet or exceed that of 4G. The first mobile 5G network launches will begin in the second calendar quarter next year, and there will be commercial launches occurring simultaneously across North America, Europe, China, Japan, South Korea, and Australia. In total, we are working with more than 18 OEMs who have committed to launch 5G handsets in 2019 based on our 5G and our X50 modems. We believe that Qualcomm is the leader in 5G, with the ability to launch sub-6-gigahertz, millimeter wave, standalone and non-standalone 5G.

Furthermore, 5G brings an order of magnitude increase of complexity over 4G across spectrum, network dark architecture, RF front-end, device form factors, especially the millimeter wave frequencies, power consumption and application and AI processors. This complexity plays directly to Qualcomm's strength as an innovator and systems provider.

Priority number two is resolving our dispute with Apple. Regarding Apple, our view on the timeline to resolve our licensing dispute has not changed. We have previously highlighted key litigation milestones in fiscal 2019 that we believe could help drive a resolution. Those litigation milestones have not changed, including the potential for multiple patent infringement rulings in China and Germany before the end of this calendar year.

Aside from infringement of unlicensed intellectual property and other claims, including the recent product-related claims, there are billions of dollars in damages in the breach of contract claims against Apple's manufacturers. We expect a trial date to be set for that matter in San Diego during the early part of next year.

We have continued to have discussions with Apple to try and reach a resolution, and we remain focused on driving the appropriate value for our stockholders, either through settlement or litigation. Resolution of the outstanding licensing disputes represents

significant value to our shareholders and provides the foundation for very strong earnings growth, separate and apart from the 5G opportunities we have described.

Priority number three is to execute well across our core product businesses. The strategic decisions we made to diversify our revenue in our mobile channel while expanding into adjacent opportunities is working. Our engagement with customers across multiple industries continues to expand, and our QCT business outside of Apple continues to grow.

Our Snapdragon 800 solutions continue to define the premium tier benchmarks, and we expanded our leadership to the high tiers with Snapdragon 700. Consistent with our expectations, the product mix is improving in the China region, and key Qualcomm China-based customers are gaining share globally, most recently in India and Europe.

In fiscal 2018, our non-Apple RF front-end revenue nearly doubled year over year, reflecting the full-year impact of the TDK acquisition and revenue growth across all key OEMs, leveraging one of the broadest portfolios of RF front-end products in the industry. Given our strong design win pipeline, we expect to grow RF front-end revenues by double-digit percentage in fiscal 2019.

In 4G, our RF front-end traction includes 80 module design wins across key OEMs such as Samsung, Google, Sony, LG, Oppo, Vivo, Xiaomi, and OnePlus. Importantly, current commercial devices such as the Pixel 3, Pixel 3XL, Samsung Galaxy Book 2, and Sony ZX3 all have our complete RF front-end modem to antenna solution. We are pleased to have established RF front-end design wins at major accounts in a mature 4G technology cycle going against more than four RF front-end suppliers. This validates the competitiveness of our components across PAs, filters, switches, tuners, and modules.

In 5G, we are well-positioned with design wins at all our key Snapdragon 800 customers. The added complexity of 5G is also driving additional RF content per device, including combinations of sub-6-gigahertz and millimeter wave. As an example, a large number of 5G smartphones in the United States will require millimeter wave capabilities at launch.

Across our adjacent opportunities, we are continuing to see exciting traction for our technologies and products in these new growth industries. In auto, our integrated platforms are driving leadership and growth across telematics, infotainment, and in-car connectivity, with an order pipeline of more than \$5 billion, up from \$3 billion earlier this year.

We are leading 5G innovation in cars and have secured the world's first major 5G design win with a leading automaker, and we are working with numerous other automakers and Tier 1 suppliers to bring 5G to vehicles. Infotainment is a particularly strong story for us given our very strong long-term order pipeline with a broad set of key global customers.

In networking, we remain the number one share leader in retail and enterprise channels and continue to gain share. We are also number one in mesh Wi-Fi, which accounted for 50% of all U.S. retail Wi-Fi network equipment sales during the first half of 2018. In fiscal

2018, leveraging our success with Wi-Fi mesh, we have expanded into the carrier segment and have significant design traction headed into fiscal 2019.

Historically, we have benefited from technology transitions, and we are now driving industry adoption of 802.11ax, now called Wi-Fi 6, with more than 50 design wins in the pipeline. Looking ahead to 60-gigahertz Wi-Fi, we just announced the industry's first 802.11ay chipset, recently-announced 802.11ad devices from NETGEAR and ASUS, and are working with Facebook on the Terragraph project.

Turning to QTL, fiscal 2018 results were impacted by the disputes with Apple and its contract manufacturers as well as the other licensee. However, global 3G/4G device trends were favorable, driven by strong trends in average selling prices. Our number of 5G licensing agreements is growing, with more than 20 agreements signed to date based on our previously-announced 5G licensing framework, including Meizu and Motorola Lenovo, and we have significantly more manufacturers in discussions for 5G agreements and amendments, positioning QTL for stability as the 5G transition gains momentum.

On regulatory matters, we are pleased to announce in August that we reached a court-approved settlement with the Taiwan FTC. As a result, the underlying decision was revoked and replaced by the terms of the resolution.

Regarding the U.S. FTC, we continue our discussions to work toward a resolution outside of the current litigation. Yesterday, the court issued a ruling in the case regarding licensing practices of certain standards organizations. This is a partial summary judgment ruling on one of the issues, and a full trial is still to come next year. In our view, the ruling is incorrect.

In addition to the product and technology actions I have discussed, we are driving operating leverage into our business by delivering on our operating expense commitments. With the potential resolution of our dispute with Apple in front of us, we believe there is a very substantial opportunity to grow value for our stockholders that is incremental to the strength of the current business. The combination of these elements leaves us well-positioned to drive stockholder value throughout fiscal 2019 and beyond.

Finally, I want to thank our employees for their hard work and focused execution throughout the past year. Our team has made great progress on our important strategic objectives, and we are extremely well-positioned for the upcoming transition to 5G and to grow into the many exciting new industries that are adding our leading-edge technologies to their products in fiscal 2019 and beyond.

I would now like to turn the call over to George.

George S. Davis {BIO 3925391 <GO>}

Thank you, Steve, and good afternoon, everyone. I will begin with comments on our fiscal fourth quarter and 2018 results, followed by our fiscal first quarter of 2019 guidance and some additional perspective on 2019 overall.

In our fiscal fourth quarter, results were strong, with revenues of \$5.8 billion, above the midpoint of our guidance range, and non-GAAP EPS of \$0.90, above the high end of our prior guidance range. Revenues benefited primarily from stronger than expected demand for chips from Chinese customers.

Non-GAAP EPS results exceeded the midpoint of our guidance by \$0.10. \$0.06 of that impact was driven by operating performance in QCT and QTL and from lower operating expenses. The remaining \$0.04 was driven by favorable tax impacts and lower share count from our repurchase activity.

QCT delivered revenues of \$4.6 billion and an EBT margin of 17%, driven by strength in MSM chip shipments of 232 million, above the high end of our guidance range on stronger than expected demand from Chinese OEMs.

In QTL, revenues were \$1.14 billion, in line with the midpoint of our guidance range, and EBT margin was 65%, better than expected, reflecting lower operating expenses, largely from litigation spending. We also recognized \$100 million of revenue from the other licensee in dispute under the interim agreement.

In our fiscal fourth quarter, non-GAAP combined R&D and SG&A expenses were down 1% sequentially on cost reduction actions and lower than expected excess litigation expense more than offsetting the impact of an extra week of operations in the fiscal fourth quarter.

Our non-GAAP tax rate was a 1% benefit in the quarter, lower than our prior expectations, reflecting a modest benefit related to tax restructuring completed in the quarter.

Now, turning to fiscal 2018, non-GAAP revenues for the year were \$22.7 billion and non-GAAP earnings per share were \$3.69. We returned \$26 billion to stockholders in fiscal 2018, including approximately \$3.5 billion of cash dividends paid, an increase of 7% year over year, and \$22.6 billion in share repurchases, largely via our accelerated programs, including a \$5.1 billion Dutch auction and a \$16 billion ASR. In terms of average price realized under the ASR, that will be based on ratable pricing over the term of the ASRs, which will run through August 2019.

Turning to 3G/4G devices, for calendar year 2018, we continue to forecast approximately 1.8 billion to 1.9 billion 3G/4G device shipments, growth of approximately 5% year over year at the midpoint. Our forecast for handset unit shipment growth in the year is approximately 100 million units lower than our forecast at the outset of the year on lower demand in both developed and emerging regions, particularly in China. Global device sales have been less impacted, as global handset ASPs have been better than expected, growing more than 10% year over year in fiscal 2018.

In QCT, we saw strong performance in fiscal 2018, with 8% year-over-year growth in earnings before tax dollars and EBT margin at 17%, with strong demand trends in China, particularly in the mid and high tiers, offsetting the impact of lower share at Apple.

In QTL, results in fiscal 2018 were significantly impacted by the disputes with Apple and the other licensee and by the related litigation costs. These dynamics mask the strong global device sales growth in fiscal 2018, as higher handset ASPs across multiple price tiers made up for the modest handset unit growth. Looking at handsets in the fiscal year, we estimate that global sales grew 13%, driven by 1% unit growth and 11% ASP growth.

Let's now turn to our financial outlook for the first fiscal quarter of 2019. We estimate fiscal first quarter revenues to be in the range of approximately \$4.5 billion to \$5.3 billion. We estimate non-GAAP earnings per share to be approximately \$1.05 to \$1.15 per share.

Our first quarter estimate assumes continuing nonpayment of royalties by Apple and the other licensee. As we have noted on previous calls, the impact of these nonpayment of royalties has largely eliminated the seasonal effects that we would normally see in QTL. Our fiscal first quarter outlook also reflects the change in our share in Apple from approximately 50% modem share in our fiscal first quarter 2018 to zero share in the flagship launches in our first fiscal quarter 2019. We have also seen our RF front-end share at Apple drop in the current launch. I will discuss the impacts here in more detail shortly.

More than offsetting the demand and share impacts in the quarter is a one-time estimated benefit of approximately \$0.45 of deferred tax asset impacts resulting from tax elections made in the first quarter of fiscal 2019 as part of our previously announced tax restructuring.

We anticipate fiscal first quarter non-GAAP combined R&D and SG&A expenses to be down approximately 5% to 7% sequentially, primarily reflecting one less week of operations. Our cost management efforts will be somewhat muted in the quarter due to timing of certain divestitures expected to be completed later in the fiscal year.

In QTL, we expect revenues of \$1 billion to \$1.1 billion in the fiscal first quarter. As a reminder, we are adopting revenue accounting standard 606 in the first quarter, which results in us moving from reporting QTL revenue in arrears to estimating revenues in the period our licensees sell their products. ASC 606 requires us to report revenue in a manner that will include an estimate of our QTL royalty revenues before all information is received from our licensees. This will lead to quarterly true-ups against reported numbers.

Despite the change in revenue recognition method, we continue to expect revenues to range between \$1 billion and \$1.1 billion quarterly in the near term, as we see more muted seasonality on the absence of Apple licensing revenues. This range also excludes any payments from the other licensee in dispute under the \$700 million interim agreement signed in fiscal 2018. As a reminder, the final \$100 million payment received under that interim agreement is being taken to retained earnings and not reported in the P&L as a result of the transition to ASC 606.

We expect fiscal first quarter QTL EBT margin to be approximately 53% to 57%, lower sequentially, reflecting the absence of the \$100 million interim payment and a change in R&D cost allocations, which I will discuss shortly.

FINAL

In QCT, we expect approximately 175 million to 195 million MSM chip shipments for the fiscal first quarter, down 20% sequentially at the midpoint, which is a result of one less week in the quarter, lower Apple legacy shipments, and lower demand from China on weaker sell-through following very strong demand in fiscal Q4.

Year over year in the first fiscal quarter, we see a large decrease in units, which is fully explained from both a unit and EBT basis by the loss of share in the new Apple devices. We expect the Apple share reduction to be most impactful in our fiscal first quarter. In fiscal 2018, Q1 units represented approximately 50% of the full-year MSM orders from Apple. Compared to the same quarter last year, Apple volumes are expected to be down 50 million to 55 million units.

We expect QCT EBT margin to be between 13% to 15% in the quarter, reflecting the lower MSM volumes and the impact from a lower mix of modem sales. We expect a recovery to high teens percentage in the second half of the fiscal year on improved product mix, the initial 5G launches, growth in adjacencies, and the impact of cost actions. We expect QCT's demand profile and EBT in the fiscal second quarter to reflect more muted seasonality, as the normal pullback in Q2 versus Q1 was historically heavily driven by Apple.

Non-GAAP interest expense net of investment and other income in the fiscal first quarter is expected to be approximately \$100 million, which is a reasonable estimate for each of the remaining quarters in fiscal 2019. We forecast diluted weighted average shares for the first fiscal quarter to be approximately 1.23 billion.

Turning to 2019, as Steve mentioned, resolving our two licensee disputes is a key driver for fiscal 2019 performance. Upon resolution, we continue to forecast significant positive revenue and EPS impacts.

For calendar year 2019 3G/4G/5G device shipments, we are estimating approximately 1.9 billion to 2 billion units, up approximately 5% at the midpoint, reflecting low single-digit handset growth, driven primarily by migrations to 3G and 4G in emerging regions, and strong double-digit growth for non-handsets.

We currently see limited macroeconomic risk to our outlook from the trade dispute between China and the U.S., as there are currently tariff-related impacts on only a limited number of our revenue drivers. For Chinese imports to the U.S., some networking products will be subject to U.S. tariffs, potentially impacting end market demand if the incremental cost is passed to consumers. Cellular phones at present are not currently subject to U.S. tariffs, and for U.S. imports to China, ICs are not currently on the China tariff list.

In fiscal 2019, we expect relatively flat global handset average selling prices and low to mid-single-digit percentage handset sales growth year over year, with strength coming from the emerging regions, providing solid end market trends for QTL once the licensing disputes are resolved.

FINAL

We are making some changes with respect to our allocation of certain technology items, predominantly in our corporate R&D spending. With the commercialization of 5G devices in 2019, the spend for device development will be reflected in QCT, consistent with past practice, and the technology development currently in corporate will largely be reflected in QTL. Also moving into QTL is a minority share of some IP technology items previously shown in QCT, but which are related to future technology.

The net effect of these changes will be decreased spend in our corporate expenses by approximately \$500 million and an increase in QTL expenses of approximately the same amount. The increases and decreases in these R&D changes are solely related to location of reporting in the segments and are not related to the cost reduction program.

The cost program remains on track to deliver \$1 billion in savings from our \$7.4 billion baseline spend. At present, we are trending somewhat above the \$6.4 billion run rate, as excess litigation expenses have increased relative to the baseline. However, we are on track to deliver the \$1 billion in operating savings and expect additional savings post-licensing resolution as litigation costs will come down significantly.

We expect the net effects of the cost reduction in corporate and other plus the change in corporate R&D expense allocation and increased interest expense to result in savings of approximately \$300 million in our Other segment outside of our core businesses in fiscal 2019.

Our forecast for our non-GAAP tax rate in fiscal 2019 is approximately 3% to 4% and reflects both the run rate tax impacts of tax reform and the fiscal first quarter impacts of our tax restructuring. Excluding the impact of the deferred tax asset item, we expect the non-GAAP tax rate to be approximately 15% for the year.

We expect fiscal 2019 weighted average diluted shares to be approximately 1.19 billion to 1.2 billion, lower year over year by approximately 280 million shares or 19% of shares outstanding on the full impact of our ASR, the Dutch tender, and open market repurchases.

In summary, we expect fiscal 2019 earnings to be heavily weighted toward the back half of the year, as the impacts of a number of factors increase over the next several quarters. We expect QCT to return to year-over-year earnings growth in the second half on growing China OEM share, initial 5G shipments, growth in adjacencies, and margin expansion. Our additional cost actions and share repurchases over the year will further lever our second half performance.

That concludes my comments. I will now turn the call back to John.

John T. Sinnott {BIO 20007481 <GO>}

Thank you, George. Operator, we are ready for questions.

Q&A

Operator

Thank you. Our first question is from the line of Romit Shah with Nomura. Please proceed with your question.

Q - Romit Jitendra Shah {BIO 16865852 <GO>}

Yes, thank you. I was hoping you could talk about the dispute with Apple. We've noticed during the quarter that there were judgments in your favor, ITC, for example, but those judgments are coming without any injunctive relief. I'm just curious why this hasn't changed your timeline on resolution. It would seem like this dynamic would allow Apple to kick the can down the road for as long as they can.

A - Donald J. Rosenberg {BIO 7569439 <GO>}

Romit, this is Don. I think you got it a little off. So the ITC ruling that you're referring to was the recommendation of the administrative law judge. We've previously given the dates, so that was the initial determination. That now goes to a final determination before the commission. It's true that he found infringement, which we were very pleased with, but he also decided that from his perspective, there shouldn't be an exclusion order issued. We obviously disagree with that, and we have the opportunity before the commission to convince them otherwise.

Q - Romit Jitendra Shah {BIO 16865852 <GO>}

In China, what do you expect? Do you think it's going to play out like it has in the U.S., or do you think there could be more punitive actions, for example?

A - Donald J. Rosenberg {BIO 7569439 <GO>}

Yeah, sorry. Your first part of your question, I think, was in China. You were asking about our actions in China?

Q - Romit Jitendra Shah {BIO 16865852 <GO>}

Just the process in China and how that might compare to what we've seen so far here in the U.S.

A - Donald J. Rosenberg {BIO 7569439 <GO>}

Sure, so I think as I've said in the past, we've got over 20 patent infringement cases in multiple jurisdictions in China, where the IP courts have shown to be very good at protecting intellectual property rights and issuing in many cases injunctions. And so we continue to press those cases, and we remain optimistic about the results of those. We've also, I should say, gone through multiple reviews of the validity of our patents that are at issue in those cases, and we have won all but one, I believe, so there are many validity findings already through the CIPO, the Chinese Intellectual Property Office.

Operator

Thank you. Our next question is from the line of Mike Walkley with Canaccord Genuity. Please proceed with your question.

Q - T. Michael Walkley {BIO 3359029 <GO>}

Great, thanks. George, I just wondered if you could walk us through some of the changes in your guidance. Earlier in the year when Broadcom was trying to buy you, you shared some financial targets for fiscal 2019. Now you've given us some startup guidance for the year that's going to be lower than those targets. Can you just maybe walk us through some of the things that might have changed, whether it's higher legal costs, a weaker smartphone market, maybe less of a buyback given the timing of NXP? Can you help us reconcile your guidance relative to the one earlier in the year? Thank you.

A - George S. Davis {BIO 3925391 <GO>}

Hi, Mike. Let me generally characterize it for you. And as we've discussed previously, the extension of the NXP contract, first from April and then to July, and then of course the termination last quarter and then the implementation of our capital return program in August, accounts for a material part of the difference, as accretion is still the biggest single difference in the share repurchase case versus NXP, which came with accretion on day one. And under the share repurchases, we've said it's the combination of the licensing resolution and the share repurchase can actually bring higher accretion than we would have seen with NXP.

I think in terms of just looking back to what we see now versus the beginning of last year, clearly we see a weaker handset market in both 2018 and 2019 than we saw at the beginning of the year, and I think that's one of the major factors. I think there's other minor factors like interest rates being higher. You've got some other factors like operating expenses related to what we were referring to as excess litigation being higher.

But the key point is the same elements that drove our earnings performance at \$5.25 and actually the higher range, which is really how we have discussed our performance post-dispute resolution, those things are all still in front of us, even with a weaker handset market overall.

So the key thing is going to be resolution with Apple, and then of course, obviously the various implications of that resolution, whether it includes possible reengagement on products, and then of course, the ultimate accretion that comes with that. We also see, quite frankly, 5G, which ramps in 2020 and 2021, as providing further underpinning to that strong earnings potential.

Q - T. Michael Walkley {BIO 3359029 <GO>}

Great, thank you.

Operator

Thank you. The next question is from the line of Tim Long with BMO Capital Markets. Please proceed with your question.

Q - Timothy Patrick Long {BIO 20374846 <GO>}

Thank you. If I could just go back to Don, you mentioned, or maybe Steve mentioned in the initial remarks about the FTC complaint and the initial decision and not agreeing with it. Could you just talk a little bit? Just a few of the questions I had, one, I thought Qualcomm had previously been licensing to modem suppliers since they're shipping in the market. And then second, is this potentially risking the whole license royalty rate based on system rather than chip? And then third, if you can just maybe talk about how the FTC may impact or may not impact some of the other Apple or ODM cases that are out there, that would be helpful. Thank you.

A - Donald J. Rosenberg {BIO 7569439 <GO>}

Yeah, sure. So the first - let me go back to the order. The first question was with respect to - no, the modem was the third question, wasn't it? Yeah, with respect to the ITC?

A - John T. Sinnott {BIO 20007481 <GO>}

No, I think it was the FTC.

A - Donald J. Rosenberg {BIO 7569439 <GO>}

Sorry, the FTC.

A - John T. Sinnott {BIO 20007481 <GO>}

Could you go ahead and repeat your question so we make sure we get the proper answer?

Q - Timothy Patrick Long {BIO 20374846 <GO>}

Sure, it was the FTC. Were you previously licensing to modem suppliers since they are selling to market, what's the impact of a potential decision on chip level versus device level? And then what's the relationship with this case potentially and anything with Apple or the other ODMs?

A - Donald J. Rosenberg {BIO 7569439 <GO>}

Sorry, I've got it now. So on modem licensing, your assumption was right. That is to say that competitive chip makers have been free to sell their chips to device makers. Our practice has been because we license to device makers that competitive chip suppliers can sell to licensed device makers and not have to pay us a license fee, and that's been the case for many, many years. There was a time long ago when we provided some non-exhaustive licenses to some chip makers, but that was in the past.

So your point is well taken because there was no need for a license - there is no need for a license on the component level as long as the device makers are licensed, which the industry has practiced since the very beginning of industry practice here. The primary

standards bodies have constantly reiterated device-level licensing is the norm, and every player in the industry has followed that process. So that's why I say I think the judge respectfully got it wrong here, and we're looking forward to an opportunity for a full trial later in January.

I think I've answered your second question as well, so I'll pass that one. And in terms of the impact, there really is, on ODMs and other Apple situations, there's no immediate impact here. We have licenses, as you know, which remain valid. This is a partial summary judgment, which the judge decided a particular issue in this case. It's not a final judgment, and so we'll just continue advocating our position in court and continue to have multiple licenses around the world, as you know.

Q - Timothy Patrick Long {BIO 20374846 <GO>}

Okay, thank you.

A - Alexander Rogers {BIO 19966795 <GO>}

Hey, Tim. This is Alex. I'm calling in remotely. Let me just jump in very quickly. On the royalty rate issue, one of the things I think is important to remember is that our licensing program with respect to essential patents in cellular is really properly valued at the system level and the device level. And so the value of this intellectual property is realized at that level, and that doesn't change by virtue of this particular partial summary judgment ruling.

The other thing I think is important to keep in mind is that we've dealt with similar issues like this before, for example, in the TFTC matter, and we found a way to resolve it there in a way that's not disruptive to the licensing business and satisfactory to the TFTC obviously. So I just wanted to add a couple of those additional points.

Q - Timothy Patrick Long {BIO 20374846 <GO>}

Okay, thanks for the extra color.

A - Steven M. Mollenkopf {BIO 16172191 <GO>}

Tim, this is Steve. Also, I would just add. In all of, I would say, the legal detail, I want to make sure the point is not lost. Really our focus here in the near term is really how do we settle the FTC case. It's been public that we've had some discussions in that regard. And that's really where the focus is right now, and there's nothing really in that order that we think complicates that or keeps us from doing that. And in the meantime, we're really not compelled to do anything differently with the business. But that's really where the focus is. Hopefully, that isn't lost in the discussion as well.

Q - Timothy Patrick Long {BIO 20374846 <GO>}

Okay, thank you.

Operator

Thank you. The next question is coming from the line of Amit Daryanani with RBC Capital Markets. Please proceed with your question.

Q - Amit Daryanani {BIO 7113568 <GO>}

Thank you, I have two as well. I guess first off, to get towards the high teens operating margin target for QCT, what sort of MSM unit expectations do you have on the back of this? I'm just trying to understand. To go from low teens to high teens, how much of this is going to be volume-driven versus some of the cost take-out benefits that you guys are already implementing? That would be helpful.

And then the second question, I think ahead of the FTC, ahead of the judge giving you this preliminary judgment, I think Qualcomm and the FTC had asked for a 30-day deferral to reach some sort of settlement. Does the ruling by the judge in any way prevent you guys from getting to some sort of settlement with the FTC away from the courts? And is that a likely option over the next six to nine months for you guys? Thank you.

A - George S. Davis {BIO 3925391 <GO>}

Amit, hi. This is George. I'll cover the MSM. We're seeing both benefits more from mix in our MSM outlook in the second half versus the first half, not so much a volume question, although it's good. But we're continuing to see a trend that we've seen before, which is a very strong volume move from low and mid up into the high and premium tiers, and that continues. And that also relates to the timing of launches in China, which Cristiano is probably better to comment on. Of course, we still expect to see some additional benefit from the cost program as well.

A - Cristiano R. Amon {BIO 3259554 <GO>}

Maybe I'll just make a small comment and hand it over to I think Don on the FTC question. So, Amit, also at the very tail end of fiscal 2019, that's when we're going to start to see the ramp of some of the 5G devices. And it's meaningful volume in fiscal 2020, but the initial launches will also happen at the very end of 2019 fiscal for us. Thank you.

A - Donald J. Rosenberg {BIO 7569439 <GO>}

And I think your question was does the partial summary judgment ruling affect our continuing settlement discussions. And I think as Steve just indicated, we have ongoing settlement discussions with the FTC and we will continue those discussions with the FTC.

Operator

Thank you. The next question is coming from the line of Stacy Rasgon with Bernstein Research. Please proceed with your question.

Q - Stacy Aaron Rasgon {BIO 16423886 <GO>}

Hi, guys. Thanks for taking my questions. I'd like to know why you're including a discrete tax benefit in your Q1 non-GAAP earnings. Did you know it was there when you gave the

FINAL

Bloomberg Transcript

guidance for 2019 last year? And does that benefit, \$0.45, go toward the \$5.25 EPS target that your compensation is based on? And if so, why is that there?

A - George S. Davis {BIO 3925391 <GO>}

Hi, Stacy. The timing of the tax adjustment item relates to the timing of the tax restructuring that we've taken. And that's been a process that has been continually under review over the last several months, but it really relates and reflects the timing of the actions.

In terms of the compensation, we still are very focused on delivering the numbers that we have talked about and that the board has based the compensation plan for management. And I think the one-time items are not the driving factor in delivering that business or those business results.

Operator

Thank you. Our next question is coming from the line of Brett Simpson with Arete Research. Please proceed with your question.

Q - Brett Simpson {BIO 3279126 <GO>}

Yes, thanks very much, a question for George. I think earlier this year during the Broadcom situation, you guided on adjacency revenue for fiscal 2019 at \$7 billion to \$8 billion from QCT. Can you give us an update on this? Just give us some sense as to what the December quarter looks like for adjacencies and how you see fiscal 2019 now playing out.

And maybe, George, can you give us some insight in terms of QCT sales overall for fiscal 2019? Just now you've given some guidance for December quarter, why we can't get a revenue guide overall for fiscal 2019 for QCT. Thank you.

A - George S. Davis {BIO 3925391 <GO>}

So adjacencies, when we look at the previous forecast, probably the biggest difference is we've seen slower adjacent growth in 2018 than we had forecasted. We start to see recovery to that growth rate in 2019. We also have seen our RF front-end business, which had an Apple component, which was in that forecast, all of that business has moved away from our front-end group. Despite that, absent that, there's been strong growth outside of Apple.

In terms of the mix, though, as we've seen some of the favorable business trends that Steve talked about, not only in the win area but in the IoT and in auto, we're actually seeing far less margin EBT impact from the slower growth than what we had forecasted as opposed to what we saw in 2018.

With respect to guidance on revenue, our practice, consistent with really what the rest of the industry does, is to give it a quarter out.

Q - Brett Simpson {BIO 3279126 <GO>}

And maybe just to confirm, can you give us any sense as to – you said \$7 billion or \$8 billion earlier this year. Can you give us a range or any insights on adjacencies for fiscal 2019 now? I understand it's slower growth.

And maybe just a separate question for Cristiano. On 5G, when you talk about Snapdragon 800 wins and the RF opportunity as well, can you maybe just frame? What is the revenue opportunity per 5G phone when you're selling a Snapdragon 800 and the RF, the complete RF front end for 5G? Thank you.

A - George S. Davis {BIO 3925391 <GO>}

Again, we're not providing an updated guide against the \$7 billion to \$8 billion. The biggest difference between the range and what we see today is really slower growth in IoT and the impact of the Apple change in our front-end business. But from – again, when I look at the EBT impact relative to our expectation to get to the earnings potential that we talked about, it's a very minor impact overall.

A - Cristiano R. Amon {BIO 3259554 <GO>}

Hi, Brett. This is Cristiano. On 5G, we expect 5G to be a significant expansion, even on existing units, both in revenue and earnings for QCT, but also likely to be an expansion of share. And we see two drivers. One is we have a lot more content in the device. Besides the performance of a premium-tier application processor and the 5G modem, we also have high traction on the RF front-end design, including the incremental value you get from millimeter wave modules, which is going to be very important. Certain markets, for example, the United States, will require millimeter wave. Thank you.

Operator

Thank you. Our next question is coming from the line of Tal Liani with Bank of America. Please proceed with your questions.

Q - Tal Liani {BIO 1643846 <GO>}

Hi, guys. You gave guidance before for expense cuts of \$1 billion. Can you discuss the linearity? Should we expect a drop in expenses early in the year, or is it going to be even throughout the year? That's for modeling purpose.

Second, your guidance for next quarter for MSM shipments was lower than expectations, I believe, that are in line with the Street. Can you discuss the areas of strength and the areas of weakness as you see it next quarter? And how do you refer to the reports about global weakness in demand for smartphones? Thanks.

A - George S. Davis {BIO 3925391 <GO>}

Great. So on the operating expense linearity, we expect to continue to see operating expenses coming down over the year and more in the back half than we would normally see in a cost reduction program just because of the timing of some of the divestitures that

are a part of it but not a key and driving part of it. The other part is just the timing of some roadmap items and when it made sense to take certain actions. So overall, we're very confident that we're on track for that.

In terms of the MSM share, maybe I'll just comment on the big deltas. I think the year-over-year is, in some ways, most instructive because that's where you really see the Apple effect. And we're down in the first quarter 55 million units versus where we were last year in the same quarter with Apple, and that's really the effect of zero share.

One of the things that I think has made the impact of that harder to see is that, in 2018, we saw very strong demand increase in China, and at the same time, the mix of that demand improved in the high and premium tier. And so the impact of going from 100% to 50% share last year was really addressed by the growth of the non-Apple business. Obviously, this quarter we don't have that same benefit. So you're seeing a front-loaded - which is how Apple ordered last year - so comparatively, a front-loaded Apple environment that we're not participating in.

A - Cristiano R. Amon {BIO 3259554 <GO>}

Maybe I'm just going to add one thing. This is Cristiano, Tal. So if you remove the Apple effect, the seasonality we see in 2019 is very similar to what we saw in 2018. And I think as George outlined, when you look on the MSM shipments versus Street, if you look at it - because, as George said, Apple front-loaded 50 million to 55 million units, you see the strength for the MSM is still with the growth on the non-Apple business. And that's why we're going to continue to see that as we go to the second half when we don't have that Apple impact anymore.

Operator

Thank you. Our next question is from the line of Timothy Arcuri with UBS. Please proceed with your question.

Q - Timothy Arcuri {BIO 3824613 <GO>}

Hi. I had two. George, so just going back to the guidance for fiscal 2019, so is the apples-to-apples number now \$4.80 versus the original \$5.25 baseline? Is that right?

A - George S. Davis {BIO 3925391 <GO>}

So, Tim, we're not re-guiding 2019 against the numbers. Again, the largest delta as I look at where we are versus - and again, it depends on whether you're looking at a \$5.25 case that had NXP coming in on day one or how do we get to the higher range that we talked about back in January of 2018. It comes down to, again, the largest part of that being the timing effect of when the share repurchase activity started, and also the impact of getting the accretion that comes with a resolution, which then I think we're in a much stronger position. Otherwise, the biggest difference is really the market is a little bit weaker than we had expected before, and the balance being things like, such as I said, the slower growth in adjacents, actually a little bit higher interest rates having an impact, and slightly higher tax rates having an impact.

Q - Timothy Arcuri {BIO 3824613 <GO>}

Okay, George. Thanks. And then there's a lot of moving parts obviously with Apple, but it seems like every call we hear more about a potential for an injunction in China. Maybe that's why they don't want to talk about units anymore, but I'm wondering. What is the catalyst for you to get an injunction? Is it a single one of these infringement cases going your way, which sounds like it might happen this quarter? So I guess the question is could you get an injunction before the end of this year? Thanks.

A - Donald J. Rosenberg {BIO 7569439 <GO>}

Hi, this is Don. Yes, as I mentioned, there are over 20 cases that we've filed in various jurisdictions within China. And the vehicle for an injunction is we request an injunction as part of the case. China, unlike some other countries, actually will issue even preliminary injunctions and not wait through a full trial for permanent injunction. But as I said earlier too, they also have a parallel process where the patent office reviews patents for validity, and we've been very successful so far there. So as soon as we get an infringement judgment in our favor, there is a real chance of injunctive relief there.

Operator

Thank you. The next question is from the line of Ross Seymore with Deutsche Bank. Please proceed with your question.

Q - Ross C. Seymore {BIO 20902787 <GO>}

Hi, guys. Thanks for letting me ask a question. I had two. First on the MSM side dropping 20%, George, you've said there were a number of things, Apple, extra week, et cetera. Can you just talk about - even if I took the Apple out, on a year-over-year basis it looks like the MSMs are flat to very slightly up. Given the dynamics of taking share in China, I'm surprised that it's not a little bit better than that, so any color on that.

And the second unrelated question is on your tax commentary, not for the quarter, but you indicated it would be 15%, I think, for the rest of the fiscal year after fiscal 1Q. Is that correct? And how does that tax rate of 15% change after you resolve the two outstanding disputes?

A - George S. Davis {BIO 3925391 <GO>}

So let me - maybe I'll start with the tax rate first. You're correct. It's 15% on the remaining quarters, which gets you at roughly 3% to 4% for the full year given the tax benefit in the first quarter. Effectively, the tax restructuring is bringing our offshore revenue onshore, and most of that revenue is going to be subject to the FDII rate, the foreign-derived income rate, which is 13% as opposed to the statutory rate of 21%.

And so I think, as we said, I think the mid-teens is still a good number to think about in terms of modeling because of that. The 15% you get pulled up a little bit because not everything falls into that bucket, and so you get pulled up a little on rate from the FDII rate.

In terms of the MSMs, I want to make sure I understand. Are you talking about sequential or year over year? Because it's a very different story as we look at sequential versus year over year.

Q - Ross C. Seymore {BIO 20902787 <GO>}

On year-over-year you're guiding to 185 million units at the midpoint. And if my model is right, I think you did 237 million in the same quarter a year ago. So if I just did the math of taking the 50 million to 55 million units that you said from Apple out of the equation, it seems like you're still only talking 180 million - 182 million units.

A - George S. Davis {BIO 3925391 <GO>}

Now I've got your question. So the difference - one of the differences, we're seeing some lower demand in China. As we said Q4, part of our outperformance in Q4 was high and premium tier devices in China. And so we're seeing that come down a little bit as sell-through for some of our customers was below expectations. So there's a little bit of a digestion period, and I think that's part of why it looks like we're not getting as much pickup year over year potentially from the growth in China. And by the way, Q1 last year was not a bad quarter for China units either.

Operator

Thank you. This ends our allotted time for questions and answers. Mr. Mollenkopf, do you have anything further to add before adjourning the call?

A - Steven M. Mollenkopf {BIO 16172191 <GO>}

Thanks. I just wanted to thank everybody for joining us on the call today. We're on the cusp of I think some very big industry transitions that we're well-positioned for' 5G, the ramp of our RF front-end business, and of course, the ramp of the design-in pipeline, particularly in auto. I just want to thank the teams for their hard work. They never took their eye off the ball this year, and I think we're really well positioned as a result going into 5G. Thank you, everyone. We'll talk to you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or

commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2021, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript