FINAL

Bloomberg Transcript

Q2 2017 Earnings Call

Company Participants

- Derek K. Aberle, President
- Donald J. Rosenberg, Secretary, Executive Vice President & General Counsel
- George S. Davis, Chief Financial Officer & Executive Vice President
- John T. Sinnott, Vice President, Investor Relations
- Steven M. Mollenkopf, Chief Executive Officer & Director

Other Participants

- James E. Faucette, Analyst
- Kulbinder S. Garcha, Analyst
- Rod Hall, Senior Analyst
- Simona K. Jankowski, Analyst
- Stacy Aaron Rasgon, Analyst
- T. Michael Walkley, Analyst
- Tavis C. McCourt, Analyst
- Timothy Patrick Long, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Qualcomm Second Quarter Fiscal 2017 Earnings Conference Call. As a reminder, this conference is being recorded, April 19, 2017. The playback number for today's call is 855-859-2056. International callers please dial 404-537-3406. The playback reservation number is 95200877.

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, everyone, and good afternoon. Today's call will include prepared remarks by Steve Mollenkopf, Derek Aberle and George Davis. In addition, Cristiano Amon 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. This call is also 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 our 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-Q, which contain important factors that could cause actual results to differ materially from the forward-looking statements.

FINAL

And now, the comments from Qualcomm's Chief Executive Officer, Steve Mollenkopf.

Steven M. Mollenkopf {BIO 16172191 <GO>}

Thank you, John, and good afternoon, everyone. We are pleased to report strong results this quarter. Fiscal second quarter non-GAAP earnings per share were $0.14 above the midpoint of our prior guidance range, reflecting a continued focus on operational performance across the businesses.

Our semiconductor business continues to benefit from both a strong product roadmap, perhaps the strongest in our company's history, as well as industry trends that bode well for our ability to further grow the semiconductor business outside of handsets. Automotive, networking and IoT were particularly strong this quarter. Several of these product lines became part of Qualcomm largely through M&A, and will be further strengthened with the upcoming addition of NXP.

Our QCT business continues to deliver a broad set of industry-leading products, positioning us well for the opportunities ahead. We delivered strong top line results this quarter, and operating margins were ahead of expectations.

Bloomberg Transcript

Our partners are already announcing new premium tier devises based on our new Snapdragon 835 mobile platform, including the Samsung Galaxy S8 and S8+, Sony Xperia XZ Premium and the Xiaomi Mi6. Additionally, the Snapdragon 835 is extending to new categories beyond smartphones such as the ODG AR smart glasses announced at CES.

Our high and mid tier Snapdragon 600 and 400 platform offerings continue to see high adoption, particularly in China with 200-plus devises in design in the 600 tier and 190-plus devices in design in the 400 tier worldwide.

In March, we announced our 205 Mobile Platform, designed to bring 4G LTE connectivity and 4G services for entry-level feature phones. And we expect OEM devices to be announced starting this quarter. The increasing number of Gigabit LTE operator launches around the world this year validates our early investment in enabling gigabit speeds across 4G networks, and our modem roadmap continues to be more than a generation ahead of the competition.

Telstra launched the world's first Gigabit LTE network and device earlier this year, and all four major U.S. carriers have announced plans to launch Gigabit LTE in 2017. Our

Snapdragon X16 Gigabit LTE modem was featured in February in a live demo of the Sony Xperia XZ Premium. And more recently, versions of the Samsung Galaxy S8, including in North America, China and Japan, also featured Gigabit LTE-based on the Snapdragon 835.

We continue to lead the industry to 5G through our 3GPP leadership, ongoing prototype efforts, announcements of meaningful 5G new radio trials, as well as our industry-first X50 5G modem.

In February, we demonstrated the first 3GPP-based 5G new radio connection and announced the extension of our Snapdragon X50 family of 5G modems to include support for the global 5G NR standard across the millimeter wave and sub-6 gigahertz frequency bands, along with backwards compatibility for 2G, 3G, 4G, including Gigabit LTE. We expect commercial products to be available to support the first large scale 5G NR trials and commercial network launches starting in 2019.

Turning to QTL, the licensing business had a strong quarter. Total reported device sales were a record, driven by strong 3G/4G unit shipments and higher-than-expected ASPs. QTL results were in line with expectations as the stronger market and improved licensing in China offset the impact of a new dispute with a licensee.

During the quarter, we returned approximately $1.1 billion to stockholders through dividends and stock repurchases. We also announced a 7.5% increase in our quarterly cash dividend, now $2.28 per share annually, reflecting our confidence in the strength of our ongoing cash flows and future earnings growth.

During the quarter, we closed on our joint venture with TDK, which is an important strategic milestone to grow our portfolio of RF front-end products and technologies. I am very pleased that we now have all the critical components to build industry-leading RF modules across tiers and to compete in the total RF front-end service available market. We also received U.S. regulatory clearance for our pending acquisition of NXP. We remain on track to close the transaction this calendar year, and integration planning continues across both companies.

Looking ahead, the adoption of mobile technologies and mobile computing is accelerating around the world. Our broad and growing set of technologies and innovations are fundamental to mobile communications and are enabling entirely new business models and ecosystems. This trend will continue for years to come as advanced 4G, 5G and other mobile technologies expand their footprint into new industries. Looking across the growing set of new industries embracing mobile technologies, we have more opportunities ahead of us than at any time in the company's history.

Against this backdrop, we have had a series of legal and regulatory challenges that have unfortunately overshadowed otherwise strong operating performance at Qualcomm. We have successfully navigated challenges like this in the past, and we have confidence in the sustainability of our licensing business, but we know these periods can generate added volatility in near-term results and require open and regular dialog with our investors,

FINAL
Bloomberg Transcript

which is something we are fully committed to providing, while we work to conclude the right deals that will deliver long-term value to our shareholders.

Most importantly, we will remain focused on investing to lead innovation in key mobile and related technologies as that has always been the core of what's placed us in this unique and unmatched leadership position. While Derek will provide more details on the recent legal challenges, we have taken several specific steps to address the KFTC and FTC matters during the last quarter.

And last week, we filed our Answer and Counterclaims in the Apple litigation here in southern California. It is important to remember that ultimately this is about a contract dispute and business negotiation, and we will work to reach the right resolution for our shareholders as we have done so often throughout our history.

Further, the company will continue to focus on developing and delivering the best products to our customers, including Apple, consistent with our track record to-date. We are optimistic about the speed of innovation in the modem and RF areas with technologies such as Gigabit LTE, 5G NR, multimode and millimeter wave becoming increasingly important. Considering the strength of both our product roadmap and R&D investments, we expect to continue to be an important supplier to Apple now and into the future.

As we continue towards the closing of our pending acquisition of NXP later this year, I thought it would be good to review some of the larger growth opportunities that will be enabled by our unique collection of technologies, sales channels and scale for the interconnected world.

First, we will lead in 5G. 5G is the interconnecting fabric for the connected world, and will drive not only an upgrade cycle in mobile, but will also enable new industries to take advantage of the mobile ecosystem.

We will continue to work closely with global infrastructure vendors and operators on 5G NR trials to drive the mobile ecosystem toward validation and timely commercialization of 5G NR. To-date, we have announced 5G NR trials with SKT and Ericsson in Korea; AT&T and Ericsson in the United States; ZTE and China Mobile in China; Telstra and Ericsson in Australia; and Vodafone and Ericsson in Europe. The interoperability testing and trials are planned to launch in the second half of 2017.

Second, we will grow our content in the device with our expanding RF front-end capabilities. We have taken a big step forward in closing the RF360 JV to transform this business, and we also have already started delivering our first gallium arsenide PAs. As we move to 5G, the device will become more complex from an RF point of view, as massive MIMO and multi-element arrays exist on many devices. And our unique ability to provide solutions across the baseband and RF will become even more important to our customers.

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

Third, automotive will continue to be a source of growth, and we are winning more than just the telematics systems. Our automotive solution, including cellular, Wi-Fi, Bluetooth and infotainment SoCs, have been adopted by every major global automaker. Our Snapdragon automotive infotainment platforms have won new designs at 12 of the top 25 global automaker brands. This strong design pipeline shows the strength of our computing solutions in the automotive market and represents an opportunity to sell multiple Snapdragons per car. With the addition of NXP, the opportunity to grow content in the car increases dramatically. And we will be uniquely positioned for ADAS and autonomous driving, a large multi-decade megatrend that is just starting. You will be hearing more from us on this important topic in the future.

Fourth, IoT will drive meaningful growth across a broad range of opportunities. Success in these opportunities will be defined by the ability to combine connectivity, computing and security along with a broad channel to serve not only industrial verticals, but a long tail of customers to deliver high complexity products and platforms that are easy for our customers to use and integrate. Here again, the acquisition of NXP will uniquely position us with IoT system solutions and channels, and builds on the success we are seeing in the business today.

Fifth, we have an opportunity to disrupt the existing suppliers of the PC and the data center. Our Snapdragon 835 is expanding into mobile PC designs running Windows 10, which are scheduled to launch in the fourth calendar quarter this year. In the data center, we announced a collaboration with Microsoft and demonstrated Windows Server running on our 10-nanometer Qualcomm Centriq processors, the first 10-nanometer server processors in the industry.

To close, we are very focused on resolving the challenges to our licensing business and business model, and we are confident we will be able to successfully navigate through this environment. At the same time, this is an extremely exciting and transformative time for our company as the technologies and products are well positioned to expand into a growing set of opportunities and will be further enhanced with the completion of our pending acquisition of NXP.

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

Derek K. Aberle {BIO 16226713 <GO>}

Thank you, Steve, and good afternoon everyone. As Steve noted, QTL had a strong fiscal second quarter with record total reported device sales of approximately $82.6 billion, up approximately 18% year-over-year and just above the high end of our prior guidance range. The record TRDS for the quarter reflects significantly increased year-over-year unit reporting from recent China licensing progress as well as ASP strength, particularly in China and typical seasonal strength in North America.

We estimate that reported 3G/4G device shipments were approximately 400 million units with an ASP of approximately $207 at the midpoints. Global 3G/4G handset ASPs are tracking consistent with our prior expectations of low single-digit percentage declines

FINAL

year-over-year. We also continue to see healthy growth in global 3G/4G device shipments.

For calendar year 2016, we have increased our estimate of global 3G/4G device shipments to reflect even stronger December quarter shipments than we previously expected, led by stronger sales in China. We estimate that approximately 1.7 billion 3G/4G devices were shipped in 2016, up approximately 10% year-over-year.

For calendar 2017, we're reaffirming our estimated global 3G/4G device shipments of 1.75 billion to 1.85 billion devices, up approximately 6% year-over-year at the midpoint. We believe that some of the December quarter shipment strength in China resulted in a modest buildup of inventory there, which we expect will be sold through in the first half of calendar 2017. We estimate that this will push some of the expected first half calendar 2017 shipments into the second half of the calendar year, and thus into QTL's fiscal 2018 instead of fiscal 2017.

The fiscal second quarter revenue and operating profit results for QTL, which were largely in line with our prior guidance, were negatively impacted by a dispute with one of our licensees. This dispute resulted in the licensee underpaying royalties of more than $150 million for sales during the December quarter. We are working to resolve this dispute but we expect the licensee, which is not one of the suppliers of iPhones to Apple, to continue to underreport its royalties until the dispute is resolved, and therefore, have factored that into our guidance for the third quarter of fiscal 2017.

Last week, we announced that an arbitration panel awarded BlackBerry an $815 million refund of royalties that have previously paid to Qualcomm for past sales. The dispute related to whether our voluntary per unit running royalty cap program applied to BlackBerry's non-refundable prepayments of royalties for a license to sell a specified number of handsets from 2010 through the end of 2015. We strongly disagree with the ruling, but it is binding and not appealable.

It is worth noting that this was a specific contract provision that was unique to BlackBerry's agreement, so this outcome has no impact on agreements with any other licensee. The contract provision also does not apply to BlackBerry sales after 2015. It is also important to note that even after this refund, BlackBerry paid royalties for all devices it sold during the 2010 to 2015 time period equal to the per unit amount specified in our voluntary per unit running royalty program.

We continue to actively pursue resolutions and protect the established value of our patented technologies in the regulatory and other legal matters in which we are involved. We have plans for addressing each of these proceedings and are confident that the QTL business will remain a strong cash flow contributor to the company for many years to come.

Regarding the KFTC, we have begun the formal legal process for both an appeal and a stay of the decision pending the outcome of the appeal, as the ruling is clearly inconsistent with the facts and the law, reflects a flawed process and represents a violation

Bloomberg Transcript

FINAL

Bloomberg Transcript

of due process rights owed American companies under the Korea-U.S. free-trade agreement. We expect to have a decision on our application for a stay in the coming months.

As to the U.S. FTC investigation, we have filed a motion to dismiss the FTC's complaint, consistent with our ongoing view that the complaint, which was filed just days before the change in administration and over a strong objection by the Commissioner who is now the acting Chair of the FTC, fails to state a plausible anti-trust claim and offers no facts or economic theory supporting the claim of competitive harm.

As to the Taiwan investigation, we are continuing to cooperate with the TFTC as we work towards finding the resolution of this matter. While certain investigations in Europe remain pending, these investigations do not involve Qualcomm's licensing business or practices.

Finally as Steve mentioned, we have now formally responded to the complaint filed by Apple here in southern California. Apple's complaint includes numerous misstatements and miss-characterizations of our agreements, negotiations and contributions to the industry. I urge you to read our answer which clearly describes in detail the facts and corrects these misstatements and miss-characterizations as well as details the value of the fundamental technologies we have invented, contributed and shared with the industry through our licensing program.

We have a strong track record of establishing and defending the value of our technologies that have played an important role in enabling the entire mobile ecosystem, including the incredible smartphone experience.

We have freely negotiated and entered into more than 300 license agreements over many years, including with the largest and most sophisticated companies in our industry. The offers we have made to Apple for a direct license to Qualcomm cellular standard essential patents are consistent with the value of our patent technologies, established by these more than 300 arm's-length license agreements and are fully compliant with Qualcomm's FRAND commitments. It is unfortunate that Apple has rejected these fair and reasonable offers.

Also, our license agreements with Apple suppliers remain valid long-term agreements, many of which were negotiated and entered into before Apple sold the first iPhone. Despite Apple's claims against Qualcomm, Apple suppliers remain contractually obligated to pay royalties to Qualcomm under their license agreements with us, including for sales of iPhones to Apple.

In our fiscal second quarter, Apple interfered with the license agreements between Qualcomm and the Apple suppliers by actively inducing them to underpay the royalties they owed to Qualcomm for sales during the December quarter. Apple withheld payment to their suppliers for sales in the December quarter in an amount equal to what Apple claims Qualcomm owes to Apple under a separate cooperation agreement between the companies.

FINAL

This was consistent with what Apple said it would do in the complaint it filed in San Diego, prior to our last earnings call. Apple suppliers then underpaid royalties to Qualcomm in the same amount. In the aggregate, this amount is approximately $1 billion.

Most of Apple suppliers have already reported the royalties they owe to Qualcomm for sales to Apple during the March quarter, and they are obligated to pay the full amount of those royalties to us. While we would expect Apple suppliers to pay the royalties they owe us under their license agreements, it is possible that Apple will continue to interfere with the Apple supplier's license agreements leading those suppliers to breach their contracts with Qualcomm by underpaying some or all of what they owe us. We expect to have more visibility into this in the coming weeks.

Given this uncertainty, our fiscal third quarter guidance assumes a range of possible payments from Apple from the Apple suppliers, but does not reflect a scenario that Apple suppliers pay nothing to us for March quarter sales.

Turning to our data center business, as Steve mentioned, we recently announced the collaboration with Microsoft to accelerate next-generation cloud services on our 10-nanometer Centriq 2400 platform, which will span multiple future generations of hardware, software and systems.

We also showcased our first public demonstration of Windows Server on ARM, running on our processors and contributed a Qualcomm Centriq Open Compute Motherboard to the OCP community. We remain on track for commercial shipments of our server processors by the end of the calendar year, and we continue to receive good feedback from our customers.

That concludes my comments, and I will now turn the call over to George.

Bloomberg Transcript

George S. Davis {BIO 3925391 <GO>}

Thank you, Derek, and good afternoon everyone. Our fiscal second quarter was another solid quarter with non-GAAP revenues of $6 billion and non-GAAP earnings per share of $1.34, up 13% sequentially. We exceeded the midpoint of our non-GAAP earnings per share by $0.14.

Better-than-expected performance at QCT accounted for approximately $0.05 of the upside on solid MSM demand and strong performance across auto, networking and IoT. The balance of the outperformance came from better-than-expected investment portfolio gains and a lower estimated annual tax rate.

QTL was in line with expectations for the quarter despite the impact of a licensee dispute, showing the positive effect of licensing progress in China, strong 3G/4G demand and a focus on cost.

In QCT, MSM chip shipments were 179 million, modestly above the midpoint of our prior guidance. QCT revenues were $3.7 billion and implied revenue per MSM was up sequentially on stronger product mix consistent with our expectations. QCT operating margin was 13%, above the high end of our prior expectations reflecting higher gross margins in mobile and better-than-expected operating results in auto, networking and IoT.

As Steve mentioned, we were pleased to close the RF360 joint venture in February. We are consolidating the results of the JV on a one-month lag basis, and it added approximately $75 million in revenue in the quarter on one-month of activity.

QTL fiscal second quarter revenues were $2.2 billion, in line with expectations. Total reported device sales were a record and exceeded our prior guidance range on strong ASPs offset by an estimated underpayment of more than 150 million related to a dispute with a licensee.

As Derek explained, Apple suppliers reported royalties in the fiscal second quarter for sales activity in the December quarter that withheld approximately $1 billion from their payments. This amount is equal to the amount that Apple claims Qualcomm owes it under a separate cooperation agreement between Qualcomm and Apple.

It is worth noting that fiscal second quarter royalty revenues were not impacted by the underpayment, because the suppliers reported the full royalties for the term of their agreement and acknowledge they were due, but underpaid by the same amount that Qualcomm is withholding from Apple under the cooperation agreement. This is consistent with the guidance we provided last quarter.

GAAP results for our fiscal second quarter reflect a $974 million reduction of revenues associated with the BlackBerry arbitration award, including estimated interests and attorneys' fees. This reduced fiscal second quarter GAAP EPS by approximately $0.48 per share.

Non-GAAP combined R&D and SG&A expenses increased approximately 7% sequentially including the RF360 JV, which was not in our original guidance. Absent the JV, we would have been at the low end of our prior 6% to 8% guidance range.

Our non-GAAP tax rate during the fiscal second quarter was 15%. We now estimate that our fiscal 2017 non-GAAP tax rate will be approximately 17%, down from our prior estimate of 18% on changes in business mix.

We returned approximately $1.1 billion to stockholders in the quarter, including $782 million of dividends paid and $283 million in stock repurchases. We ended the quarter with cash and marketable securities of $29 billion. The balance sheet this quarter merits some additional commentary to explain the impacts of the licensing-related matters as well as the close of the RF360 joint venture.

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

First, there were notable adjustments associated with our joint venture with TDK. As a reminder, we are fully consolidating the results of this joint venture as we have the ability to control the business. As a result, our balance sheet reflects the addition of approximately $3.1 billion of the JV's net assets including $1.7 billion of intangible assets in goodwill, $800 million in property, plant and equipment, $260 million in inventory and $250 million in accounts receivable.

Our accounts receivable balance at quarter end also reflects the approximately $1 billion due from Apple suppliers. And we continue to carry approximately $1 billion in other current liabilities for the unpaid disputed amounts with respect to the cooperation agreement with Apple, which expired at the end of calendar 2016. Note that these unpaid disputed amounts have been accrued as a reduction to revenues in our P&L over the past few quarters.

Also included in other current liabilities is $974 million related to the recent BlackBerry award, which we expect to pay in the next few months, and $921 million related to the KFTC fine, which was paid shortly after the end of the fiscal second quarter.

I will now turn to our fiscal third quarter. Our guidance range for earnings per share is wider than our typical practice, primarily due to the uncertainty around whether Apple suppliers will withhold some portion of the royalty payments they are obligated to pay under their contracts with us.

We have considered a variety of scenarios within the range. However, our guidance range does not include the case where no payments are made by Apple suppliers. We will update our guidance if we subsequently learn of any action that would take us materially outside of the announced guidance range.

We have also assumed in our guidance that the licensee dispute that Derek mentioned, which arose in the fiscal second quarter, remains unresolved in the third quarter and will result in an underpayment relative to what the licensee owes for the third quarter.

As a reminder, we are coming off the seasonally strong fiscal second quarter for QTL, and our fiscal third quarter typically reflects our low quarter of the year for both revenues and EPS on a normalized basis.

We estimate revenues to be in the range of approximately $5.3 billion to $6.1 billion. The year-over-year comparisons for both revenue and EPS are impacted by more than $400 million in catch-up licensing revenues recorded in the third quarter of fiscal 2016.

We estimate non-GAAP earnings per share in our fiscal third quarter to be in the range of approximately $0.90 to $1.15 per share. We expect fiscal third quarter non-GAAP combined R&D and SG&A expenses will be up approximately 2% to 4% sequentially, primarily due to a full quarter impact of the RF360 JV operating expenses and growing spend on litigation matters.

In QTL, we estimate total reported device sales between $59 billion and $67 billion will be reported by our licensees in the June quarter for shipments they made in the March quarter, down sequentially compared to the seasonally high holiday quarter shipments reflected in fiscal Q2. This includes estimated 3G/4G device sales from Apple's contract manufacturers as well as from the licensee currently in dispute in underpaying.

In QCT, we anticipate MSM shipments of approximately 180 million to 200 million units during the June quarter, higher sequentially at the midpoint despite the excess inventory at certain OEMs in China exiting Q2. We expect inventory levels at those OEMs to largely correct within our fiscal third quarter.

For the Snapdragon 835 premium-tier chipset, we are seeing strong demand exceeding supply. Our growth in operating margin relative to demand in the quarter is being limited by our ability to ramp volumes at 10-nanometer. And we expect this to begin to normalize in the fiscal fourth quarter. We expect QCT's fiscal third quarter operating margin to be approximately 13%, plus or minus 100 basis points, reflecting year-over-year improvements as we continue to gain traction in adjacent opportunities, particularly auto, IoT and networking.

Our current expectation is that we will be in the capital markets in the second half of fiscal 2017 to fund the remaining portion of our acquisition-related needs. We continue to sell longer dated and higher volatility assets in our treasury investment portfolio in anticipation of funding the close of our pending NXP acquisition later in the calendar year.

Based on the current market environment, we expect the total of net investment income and interest expense for fiscal 2017 to be flat to down modestly on a non-GAAP basis versus fiscal 2016. The outlook has improved somewhat on the higher yields on short-term assets.

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

Your first question comes from the line of Rod Hall with JPMorgan. Please go ahead.

Q - Rod Hall {BIO 16261297 <GO>}

Yeah. Hi, guys. Thanks for taking the question. Hope you can hear me okay. I just wanted to clarify, George, what you guys are saying about the withholding, and Derek as well. And so, our understanding that the rebates, the alleged rebates, were withheld for a

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

couple of quarters. And so, it sounds like what you're saying is, the amount of royalty withheld is catching up for two quarters of rebate withholdings and I just want to clarify that that is in fact the case.

And then, I also wanted to see if you guys could give us any further color on the guidance range. And are you assuming that the royalty withholdings at the midpoint would be equivalent to these rebates that are allegedly not being paid? And then how does the top and bottom end of that EPS range figure into what you're assuming on royalties? Thanks.

A - Derek K. Aberle {BIO 16226713 <GO>}

Hey, Rod. This is Derek. So, if you think about Q2, which we had talked about last quarter and now are reporting, obviously, for this quarter, basically what happened is, we have a dispute with Apple as to whether we owe them about $1 billion under a cooperation agreement we have. That spans over several quarters of possible payments. What they said in their complaint and what they ended up doing as it relates to the second quarter, which are sales through the end of December of 2016, they effectively withheld payment to their contract manufacturers who then in turn withheld payment to us of royalties that were owed under the contract manufacturers' agreements with us, in the amount of this disputed cooperation payment, which is about $1 billion.

And so that is all reflected in Q2. And as George mentioned, because the amounts were reported to us and acknowledged as due and then we have the cash that we haven't paid to Apple, effectively we took the revenue in Q2 for the amount of the full royalties that were paid net the reserve we had for the payments that are being disputed going back towards Apple. So that's the situation on Q2.

On Q3, the guidance as we mentioned includes sort of a variety of possible assumptions on what may play out in terms of what gets paid to us by the contract manufacturers for Q3. I would say, the high end of the guidance would be reflective of us getting paid in full, but we've got some other scenarios that are reflected in the range. The agreement itself with Apple, which is where we have the dispute over what is owed to them, expired at the end of 2016, so has really no relevance or impact to what the contract manufacturers would owe us for sales during the March quarter, which is the guidance we provided for Q3.

One last point on this is, what is not contemplated in the guidance range is for the contract manufacturers to pay us nothing or a very little amount. If that were to happen, then we would update you all.

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

Rod, let me add one thing as well. When you look at Q2, you can look to the balance sheet and see the accounts receivable has had a fairly significant pop, not only because we've brought in RF360 but the receivables up by the – $1 billion of that is the amount owed by the CMs, which are not disputing the fact that they have reported and are obligated to pay under the contract for this amount. So, it is shown as a receivable. We are still holding the $1 billion related to the dispute from the prior quarters under current liabilities on our balance sheet.

Operator

Your next question comes from the line of Kulbinder Garcha with Credit Suisse. Please go ahead.

Q - Kulbinder S. Garcha {BIO 3484375 <GO>}

Thanks. Along the same subject, I'm afraid. Just a clarification. Your bundling was withheld by the contract manufacturers, but something was paid to you, something else was paid to you above that level, I assume. And isn't that a good lead indicator for being paid going forward, or am I thinking about it wrong? And then...

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

No. Yeah, go ahead and ask your second question and we'll jump in.

Q - Kulbinder S. Garcha {BIO 3484375 <GO>}

Yeah. And then the other question was really more strategic about how this Apple and Qualcomm thing plays out. The Foxconn agreement you have, is that due to expire anytime soon? I assume it's not because you haven't told us it's about to. I just want to clarify that.

And it's very rare from what I can remember, where you have an agreement with a party and they just stop paying you. You've had deals expire in the past and you've had disputes perhaps. And you have people under-report and then you audit. But has there ever been a scenario where you've had an agreement that lasted some period of time and the vendor in question just stops paying?

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

So, Kulbinder, I'll take the first part of the question, which is, what they paid to us was simply the difference between the full amount owed under the contract minus the disputed amount. So there was some incremental payment that came in, but it was net of that $1 billion that we've described in the prepared remarks.

A - Derek K. Aberle {BIO 16226713 <GO>}

Yeah. And just to add to that. This is Derek. The cooperation agreement between Qualcomm and Apple, as I said, expired at the end of 2016. So, unlike Q2, there really is no basis on which to even argue that there should be a payment of something less than the full amount that the contract manufacturers owe to us.

In terms of the Foxconn agreement, it's a long-term agreement. It is not set to expire any time soon. Those are again long-term agreements that are valid and binding and include the contractual obligation to pay. The only thing that expired was the direct agreements between Qualcomm and Apple, and those went away at the end of 2016.

FINAL
Bloomberg Transcript

And to your last point, yeah, it's been very rare. Actually, as I sit here, can't think of a situation where somebody just simply stopped paying us entirely under their agreement where we didn't have a dispute with them as to what they owed or some other thing going on. So, that would be rare.

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

And this is Don. Just to add one or two things. So, to be clear, the excuse that the contract manufacturers used was that Apple wasn't paying them and what Apple was saying was that they are holding back payment to them to match payments that they claim we owed them from the other agreement, the BCPA. No connection to the license agreement between us and our contract manufacturers.

So, it was totally improper for the contract manufacturers to withhold. And we now look at what they're going to do going forward and we say, well, even the excuse that they used before that is Apple claiming that they were making up for amounts that we didn't pay them, doesn't exist anymore. So, there doesn't seem to be even an arguable rationale reason for anybody to withhold payments.

Operator

Your next question comes from the line of Mike Walkley with Canaccord Genuity. Please go ahead.

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

Great, thank you. Just staying on this topic, just trying to understand maybe the guidance and the accounting ramifications. One, you have a licensee that you're dispute with and you didn't recognize $150 million in revenue. And I think when you had a dispute with Nokia going back in time, when they materially underpaid during that process you withheld Nokia revenue from your guidance. So, if, say, the contract manufacturers pay some smaller dollar amount that Apple theoretically said they should pay them, do you still recognize a portion of that revenue or do you just take Apple out altogether like maybe you've done with some other licensees. Just trying to understand the accounting ramifications if there is any change from your licensees.

And then my more fundamental question, just on the outlook for QTL, if you could help just walk us on a sequential between seasonality, the Apple range and then this licensee dispute and maybe if you could help us just see the sequential decline kind of those different puts and takes that would be helpful. Thank you.

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

So, in terms of taking revenue in the case of a dispute, typically if there is a formal dispute then we would not take revenue until the dispute is resolved. And I'll let Derek or Don comment on what constitutes formal dispute, but certainly entry into arbitration or lawsuit is one case in the past. For the customer in the second quarter, the customer reported fully and underpaid, and has not filed a formal dispute. And in that case, we take the

FINAL
Bloomberg Transcript

revenue for the amount paid while we're working on collecting the balance owed from the customer. And then, do you want to add to that at all?

A - Derek K. Aberle {BIO 16226713 <GO>}

Yeah, I think just the difference, Mike, this is Derek, in the two scenarios. The situation where you have the current dispute where we didn't take revenue this quarter, about $150 million – a little more than $150 million. That situation where we did not get paid, so typically if there is a dispute and we're not getting paid, we wouldn't take the portion that's being withheld, which is different than if we are getting paid.

On your sequential question, I think really got to remember the Q2, obviously, is the seasonally high quarter for the year. December quarter, obviously, typically the high quarter for QTL. So there would normally be a sequential decline going into Q3. I think other factors to consider, I would say, we're assuming, as I mentioned in my remarks that, this dispute will not get resolved with the licensee we mentioned in Q3. So, Q2 to Q3 we're both assuming an underpayment and we have a range of possibilities in the assumptions for what we'll get paid from the contract manufacturers supplying to Apple.

If I up-level it to the market, the market I think continues to be quite strong. I would say it played out just a little bit differently in terms of what came in, in Q2 versus Q3. You look at the TRDS range, we were above the high end slightly of the Q2. TRDS range because of the phenomenon of just more sales into China with a little inventory build that we expect will get sold through in Q3, which is then, therefore, a bit of a drag on Q3 TRDS. So, I think those are sort of the main drivers to keep in mind.

Operator

Your next question comes from the line of Tim Long with BMO Capital Markets. Please go ahead.

Q - Timothy Patrick Long {BIO 21123922 <GO>}

Thank you. Just two quick ones if I could here. First, I just want to clarify the guidance for next quarter, are you still booking the operating expenses or COGS hit that you're taking for the payment that was going back to Apple previously under that agreement? So, if you can clarify if that's still hurting your EPS and reserving against it on the balance sheet and when would that change.

And then secondly, on the licensee with the $150 million dispute, Derek, could you talk a little bit about, I know you can't get into too much of the details, but I just want to understand, is this something that maybe is a byproduct of other licensees seeing some of these special Apple agreements that were mentioned in their dispute and the BlackBerry arbitration? And if not, are you getting a lot of phone calls from other OEMs that have seen these other deals that they maybe do not have and understanding they have separate arrangements, is that potentially causing any renegotiations? Thank you.

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

FINAL
Bloomberg Transcript

Tim, in terms of the accruals that we've taken, those stopped as the contract expired at the end of the calendar year with the last period that that would be reported in for us was in fiscal Q2. And just a reminder, we didn't characterize sort of where those were accruing on the P&L and all that. So I don't want to make it sound like we're validating your description of them.

On the second point, I think the way to think about that is the licensee with which we have a dispute now, those discussions with the licensee, I would say, have been ongoing for some time and predated the filing of any of the litigation between us and Apple. A lot of times these discussions will go for a period of time before they escalate into a dispute. And so, the timing is what it is, but I think it's important to note that the discussions leading up to the dispute predated either the BlackBerry or the Apple litigation.

And I don't really see a connection to that. If you think about the BlackBerry decision, it really is an isolated agreement. And as I mentioned in my remarks, even after we make the refund, the amount that BlackBerry paid per unit during that time period was basically consistent with the caps that we have for premium-tier devises. So, I don't anticipate really any impact from that decision on what other licensees would claim in terms of what it means to their agreements.

The Apple situation, as we mentioned in a lot of detail in our response, the terms under those agreements, I think, were grossly miss-characterized in Apple's submission. So, yes, we've had to have some discussions with licensees to try to clarify what it is and isn't, but I would say that's sort of normal course discussions we would typically have with companies.

A - Derek K. Aberle {BIO 16226713 <GO>}

Tim, I would add that, as I said in my prepared remarks that the disputed amounts under the cooperation agreement were accrued as a reduction to revenues in the P&L. So, we can give that level of commentary.

Operator

Your next question comes from the line of James Faucette with Morgan Stanley. Please go ahead.

Q - James E. Faucette {BIO 3580933 <GO>}

Thank you very much. Just a couple of questions. First, on the topic of royalties from the contract manufacturers, have you received any payments since the original lawsuit was filed? And is that part of the reason that you feel comfortable assuming that at least some royalties will be paid in the June quarter?

And then I did want to touch quickly on the NXPI acquisition. Any update on timing of other regulatory body approvals? And can you give us a rough outline yet as to what the financing cost for that portion will be or what the interest rates may look like et cetera, if and as that deal closes? Thank you very much.

FINAL
Bloomberg Transcript

A - Derek K. Aberle {BIO 16226713 <GO>}

James, this is Derek. On your first question about the contract manufacturers, so, yeah, for Q2, what was reported and owed to us by the contract manufacturers actually exceeded the amount that's in dispute between Qualcomm and Apple under the cooperation agreement. So, we did receive payment under those licenses for the difference as George mentioned between what those companies owed and basically the disputed amount that Apple withheld.

And for the Q3, basically, we've already received royalty reports from most of the contract manufacturer suppliers to Apple, and believe there is a clear and binding payment obligation as it relates to those payments and there is no dispute about other money that is owed from Qualcomm to Apple.

So again, if these licensees are operating in accordance with the terms of the agreement, they should pay and they should pay the full amount, but again, we're a little cautious until we actually get the payment in hand. And so that's reflected in the guidance as well as just pointing out that the situation where there's zero payment is not reflected in our range today.

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

And this is Don. On the NXP question. So, yeah, we're pretty much moving as expected. As Steve mentioned, we've passed the HSR process in the U.S. We should be filing very shortly in Europe. And we've filed in China already. That has not yet been docketed by China, but it's there. And we would anticipate filing in the other jurisdictions very quickly after we've completed filing in Europe. So, we believe we're still on track and we're moving forward.

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

On the financing front, again, we expect to be in the market in the second half. We have not put out an estimate yet on the financing costs. No material change in our expected sizing, which was between $10 billion and $12 billion of acquisition debt, but the form of that debt, the term and the tenor will all have an impact on estimated cost and we're not locked down on those yet.

Operator

Your next question comes from the line of Simona Jankowski with Goldman Sachs. Please go ahead.

Q - Simona K. Jankowski {BIO 7131672 <GO>}

Hi. Thank you very much. First, I just wanted to clarify if the payments to Apple under the BCPA were previously reported as contra-revenues in QCT or in QTL? And then the question on the new licensee that was underpaying in the quarter, did they still pay the majority of what they owed you or was the $150 million that they underpaid in fact the majority of what they owed you?

FINAL
Bloomberg Transcript

And then along the same lines, your accounts receivable increased by about $2 billion, of which you commented that $1 billion was due to the Apple withholding and then some of that was the TDK joint venture, but in the filing in the Q, you also say that some of the increase was due to the delayed payments of other licensees. So I was just curious if there are other potential disputes that contributed to that or if that's just purely timing.

A - Derek K. Aberle {BIO 16226713 <GO>}

Hi, Simona. This is Derek. Maybe I'll take the first two and then George can take the last one. Yeah, the amounts that are in dispute between us and Apple as we mentioned last quarter have been fully accounted for and run through the P&L in prior quarters. We did not specify sort of where in the P&L the various payments were flowing, and I think at this time are going to continue on that path.

As to the dispute with the licensee, I'm not sure I can characterize majority versus minority, but they did pay a significant amount of royalties to us and didn't withhold. They withheld only a portion of what they owed, not the entire payment.

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

So, on the accounts receivable outside of the Apple-related $1 billion and the RF360 amounts, what you had was growth in receivables related to QCT, which was just a timing issue for payment relative to when shipments were made. And then on the QTL piece, that is really just the timing of payments that are being made on some of the catch-up payments where they're spread out over a short period of time just to allow customers to get caught up in addition to fully paying at their new run rate.

Operator

Your next question comes from the line of Stacy Rasgon with Bernstein. Please go ahead.

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

Hi, guys. Thanks for taking my questions. First, I know you're making the point that the contract manufacturers are under obligation to pay no matter what they're getting from Apple, but let's be honest. They're going to pay you whatever they get from Apple, presumably. So, given what you know at this point of Apple's intentions, how can we assess that risk? Does the fact that you aren't contemplating Apple completely ceasing their payments suggest that you judge their risk of that happening to be low or is it just not a scenario that you want to contemplate at this point?

And on the revenue recognition, I think you gave us some good color on kind of what constitutes a deferral versus not, but let's just say hypothetically next quarter the contract manufacturers were to pay you 50% of what you believe they owe you for Q3. Would you be able to recognize all that 50% or would you have to defer at that point and send it to arbitration and call it zero? How do we think about revenue recognition depending on what's coming in?

FINAL
Bloomberg Transcript

FINAL

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

Stacy, this is Don. Maybe a couple of us who want to respond to the first question, but yeah, to start with, you said, I understand it's a figure of speech, let's be honest. We are being honest. And what is a good thing to think about is, I disagree with you that it's a foregone conclusion. As I said earlier, Apple's claim in its case against us is that they withheld the specific amount of money in payments to their contract manufacturers because they said it's an offset against moneys that they claim we withheld from them improperly in another contract.

While we disagree with that claim obviously, the rationale for that no longer applies. As Derek said earlier that BCPA contract is expired. So, there are no more moneys even arguably due from us to them. And therefore, no basis or rationale to continue withholding from the contract manufacturers. And as Derek also said, the contract manufacturers have valid binding contracts with us, and our expectation is that they will abide by those obligations and pay us the amount they owe us, which they've reported for the quarter.

A - Derek K. Aberle {BIO 16226713 <GO>}

Stacy, this is Derek. I think on your second question, I think probably the best way to think about it is, we'd have to wait and see all of the circumstances under which the revenue got reported and paid to us to sort of make a final judgment on that, but at a high level, I would say, we have binding valid agreements with them. If they reported half of what they owe and paid that to us, I think the most likely scenario is as long as we're not in litigation with them that we would recognize that revenue within the quarter that it's paid.

Operator

Your next question comes from the line of Tavis McCourt with Raymond James. Please go ahead.

Q - Tavis C. McCourt {BIO 3300948 <GO>}

Hi. Thanks for taking my questions. The $150 million or so license payments that have been withheld in the second quarter, was that contemplated in your second quarter guidance, or was that something that happened after the last report?

And then, so just to be clear, on the contract manufacturers payments for your third quarter guidance, the high end of the guidance would presume they pay in full, but there is no presumption of, obviously, the cooperation agreement payments from you towards Apple in that guidance. Is that correct?

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

Let me start with your first question, which was, we did not contemplate the underpayment in the Q2 guidance. It's one of the reasons why we made the point that actually if you factor that out, it was a strong quarter for QTL. They were able to come in at expectation despite that, and you saw that in the strength of the market and also the strength in ASPs. They also worked hard to manage cost.

Bloomberg Transcript

In terms of our guidance for Q3, again, we've looked at a variety of scenarios. I'm not going to lay out every one of the scenarios, but the things that we thought could happen, we are anticipating in our guidance that we have not resolved the dispute with the one customer that made the underpayment in Q2, so that is factored into our guidance. And then there is a variety of scenarios for the Apple contract manufacturers and also just a normal range of uncertainties that we have when we give guidance.

FINAL

Operator

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>}

Well, I just want to thank everyone for joining us today. I also want to thank the employees for delivering a great quarter, in particular the folks who are delivering on the new businesses. That was really a strong quarter and appreciate all the hard work. We'll talk to everybody next quarter. Thank you.

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.

Bloomberg Transcript