

## Q3 2017 Earnings Call

### Company Participants

- Cristiano R. Amon, EVP-Qualcomm Technologies, Inc. & President-Qualcomm CDMA Technologies
- Derek K. Aberle, President
- Donald J. Rosenberg, Executive Vice President, General Counsel & Corporate Secretary
- 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

- Doug Clark, Analyst
- James E. Faucette, Analyst
- Kulbinder S. Garcha, Analyst
- Rod Hall, Analyst
- Romit Shah, Analyst
- Ross C. Seymore, Analyst
- Stacy Aaron Rasgon, Analyst
- T. Michael Walkley, Analyst
- Tal Liani, Analyst
- Tavis C. McCourt, Analyst
- Timothy Patrick Long, Analyst
- Vijay Raghavan Rakesh, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Qualcomm third quarter fiscal 2017 earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. As a reminder, this conference is being recorded, July 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 38395118.

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, 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 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.

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. I want to first take a few minutes to discuss the performance of the company, both in the quarter and against our longer-term goals before providing my perspective on the legal and regulatory matters impacting the company.

I am very pleased that in a time of these external challenges, our employees are executing well on our expansion into new opportunities, and at the same time, improving the competitive strength and profitability of our industry-leading products. We reported fiscal third quarter non-GAAP earnings per share and revenues consistent with our revised guidance and above the guidance range midpoint, driven by better than expected product mix in our semiconductor business.

Our QCT business is executing very well, with profitability up both sequentially and year-over-year. QCT has now delivered improved year-over-year quarterly profitability for five consecutive quarters on strong execution as we have continued to refresh our product roadmap, delivered improved product cost and grow EBT margins despite the impact of second sourcing at Apple over the same time period.

In mobile, QCT continues to see strength in the highly competitive China region and is executing well across all price tiers. Our gigabit LTE and 5G leadership, combined with our Snapdragon 835 and new Snapdragon 600 products, are well ahead of our competitor's solution.

We continue to see good traction in our QCT adjacent opportunities of automotive, networking, mobile compute and IoT, where our efforts to deliver our technologies are

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gaining momentum. We saw strong revenue growth in those adjacent businesses in fiscal 2016 and forecast growth of more than 25% in fiscal 2017.

As reflected in our fourth quarter MSM guidance, we expect QCT's strong performance to continue. We are ramping investment necessary to extend our leadership position in 5G as operators and customers seek to accelerate their launch date. We now believe that both millimeter wave and sub-6 gigahertz capability will be table stakes for 2019 5G launches.

The modem technology and complexity is increasing and we believe we can continue to outperform our competitors with our level of 5G innovation. It is clear that our technology position and product roadmap are as strong as they have ever been.

In addition, we believe the pending NXP acquisition will provide us with greater scale in automotive, IoT, security and networking with their highly complementary product and world-class sales channel, serving a long tail of customers that are driving growth. The combined company will be a technology and semiconductor leader with future annual revenues projected to be more than \$30 billion. The NXP transaction remains on track to close by the end of calendar 2017. We have regulatory clearance in four jurisdictions, including here in the U.S. and Taiwan, and we continue to make progress in our work with regulators in five remaining regions.

In QTL, third quarter results and fourth fiscal quarter guidance reflects the impact of our dispute with Apple and the licensee dispute that we disclosed last quarter. Despite the near-term financial impact to our business by the actions of a small number of powerful industry players, the long-term outlook for our licensing business continues to remain strong, with more than 300 freely negotiated global license agreements and a technology portfolio that is fundamental to the performance of wireless and mobile computing devices today. And for many years to come, the licensing business will continue to be a significant revenue and profitability generator for the company longer term.

Moreover, it is important to remember that 3G/4G device trends, which are a key driver of QTL financial performance, remain very healthy. We are forecasting 3G/4G device shipment to grow by approximately 6% in calendar 2017. The long-term growth outlook for units, combined with moderating ASP decline, are consistent with our prior expectation for longer term global 3G/4G device sales growth.

Turning to the current legal matters, we believe we hold the high ground with regard to the dispute with Apple. We will take the actions that are needed and appropriate to defend the tremendous value that our innovations bring to this industry, innovation which enable a competitive ecosystem to thrive. You have now seen some of the steps we have taken in our dispute with Apple, including the filing of patent actions in the U.S. ITC and in U.S. and German court to address the use of our unlicensed IP in their devices.

We do not take these challenges lightly and we are focused on achieving the right long-term result for the licensing business, which also is in the best interest of our stockholders. We know that fundamentally, these issues are driven by commercial interests and contract

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negotiations, and we will continue to work to reach resolutions as we have done in the past.

As you know, we have a strong relationship with Apple for many years and they have been a longstanding and valued customer. We intend to continue to provide them with our industry-leading products and technologies, as we always have, and do our best to remain a good supplier to Apple even while this dispute continues. Derek will provide further detail on the actions we have taken in connection with our dispute with Apple as well as the specific steps we have taken in the other matters to defend the value of our innovations and our business model.

Looking ahead, our innovations, driven by decades of R&D investment, are at the forefront of multiple new industries and product categories. Our intellectual property has never been more valuable and relevant and the opportunities ahead for Qualcomm have never been greater.

Our breadth of technologies and product continues to benefit from our ongoing strategy to invest ahead of the industry, and combined with our global scale and partnership, we are extremely well-positioned to grow into an expanding step of new opportunities. Further, with the pending NXP acquisition, we will further accelerate our move into these new exciting industries.

I will now turn the call over to Derek.

**Derek K. Aberle** {BIO 16226713 <GO>}

Thank you, Steve, and good afternoon, everyone.

QTL fiscal third quarter revenues were \$1.2 billion, with earnings before tax of \$854 million. As Steve mentioned, QTL fiscal third quarter results reflect nonpayment of royalties on Apple products by Apple's contract manufacturers, as well as the nonpayment of royalties by the licensee with which we have a dispute that was disclosed last quarter.

During the fiscal second quarter, the licensee reported and paid only a portion of the royalties it owed under its license agreement, and at that time, we expected the licensee to continue to report and pay some but not all of the royalties they owe for the fiscal third quarter. Although we remain in discussions with this licensee in an effort to resolve the dispute, the licensee did not report or pay any royalties during the fiscal third quarter. This is a dispute as to the terms of the licensee's existing agreement that is similar to a number of the ones we have resolved in the past, and we expect to be able to do that again here.

With Apple's contract manufacturers refusing to fully report their total reported device sales for Apple products, and the licensee with which we have a dispute also withholding reporting, we are not providing quarterly actuals or guidance for total reported device sales and related unit shipments and ASPs by our licensees because a significant portion of quarterly activity is not available and would not be included in those metrics, making

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them incomplete and of limited value. We are, however, providing quarterly QTL revenue guidance to help our investors model our expectations for the licensing business going forward.

Despite the near-term impact of these items, which we believe we will be able to resolve over time to QTL financial performance, it is important to note that 3G/4G global sales and device trends remain very positive. For fiscal 2017, global 3G/4G handset ASPs continue to track consistent with our prior expectations of low-single digit percentage declines year-over-year. Global ASP trends continue to be strong this year with ASPs continuing to increase in China and for devices sold by Chinese OEMs globally. We also continue to see healthy growth in global device sales for the fiscal year consistent with our longer-term growth expectations of mid single-digit annual percentage increases.

For calendar 2017 3G/4G device shipments, we continue to estimate shipments of 1.75 billion to 1.85 billion devices globally, up approximately 6% year-over-year at the midpoint. Our licensing and compliance initiatives remain on track and continue to bear fruit. Excluding the effect of the underreporting caused by the disputes with Apple and its contract manufacturers, as well as the licensee I just described, which we do not view as compliance issue, we estimate that the level of compliance by our licensees for sales during the March quarter was in line with sales by our licensees during the December quarter.

As you have seen from our recent announcements, we continue to actively pursue resolutions of the challenges to our licensing business that have been orchestrated by a few of the most profitable and powerful companies in the world, and to defend the well-established value of our patented technologies in the regulatory and other legal matters in which we are involved.

In our appeal of the Korean FTC decision, hearings were held last week in the Seoul High Court on our motion to stay the remedial portion of the KFTC's order while we proceed with the appeal. We expect to get a decision on the request for a stay in the coming months.

The U.S. FTC lawsuit is on track to be tried at the beginning of 2019. We look forward to demonstrating that many of the facts alleged in the complaint are wrong and the FTC's legal theories are without merit.

As to the Taiwan FTC investigation, we continue to work to find a resolution and are continuing to cooperate with the TFTC. We also continue to work through additional investigations in Europe. However, those investigations do not target Qualcomm's licensing business or practices.

Finally, as Steve mentioned, we have now filed patent infringement complaints against Apple with both the International Trade Commission and in Federal Court in the U.S. The six patents asserted in those actions enable high performance in a variety of areas of the smartphone while extending battery life. Each of the patents does so in a different way for different popular smartphone features.

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While the technologies covered by the patents are central for the performance of the iPhone, including antenna performance, graphics, higher data rates and network capacity, flashless boot, and power management, the asserted patents are not essential to practice any standards in a mobile device or subject to a commitment to offer to license those patents. We expect that the ITC investigation will commence in August and that the case will be tried next year. We expect the Federal Court case to trail the ITC action or be stayed pending the conclusion of the ITC action.

This week, we also filed two patent infringement lawsuits in Germany against Apple seeking damages and injunctive relief for iPhones imported into or sold in Germany. The patents we are asserting in these cases represent two technologies important to iPhone function. But again, they are not standard essential patents and are not subject to any commitments to license those patents. Similar to the ITC process here in the U.S., we expect this litigation in Germany will move on a fairly fast timeline, with an outcome likely in approximately 12 months.

In addition, we have filed a motion asking the federal court in San Diego to require Apple's contract manufacturers to comply with the terms of their license agreements with respect to Apple products while the various cases are heard. Before it instructed its contract manufacturers to stop paying royalties to Qualcomm, Apple had been indirectly paying royalties on its products based on the contract manufacturer agreement for 10 years. Nothing has changed. Apple continues to generate substantial profit by using our technology and the contract manufacturer agreement remained valid. There will be a hearing on that motion in mid-August.

Yesterday, Apple's contract manufacturers responded to our claims against them and the motion I just described. In addition, Apple sought to oppose our motion in the contract manufacturer cases as well as to consolidate the contract manufacturer cases with the Apple cases. These filings by Apple and its contract manufacturers prove what we have been saying all along. Apple has interfered with our license agreement with its contract manufacturers by instructing them not to pay the royalties they owe for sales of Apple products, and then agreed to indemnify and protect the contract manufacturers against any damages and payment they will owe to Qualcomm as a result of Apple instructing them to breach their license agreement.

It is clear that Apple is controlling all of the contract manufacturer's statement and actions in the litigation. If Apple hadn't interfered with the licenses and instructed the contract manufacturers to take these actions, the contract manufacturers would not be contesting the licenses now. It is important to remember that in most cases, our license agreements were negotiated and entered into with the contract manufacturers before Apple ever entered the smartphone market, and then Apple decided to rely on them for a decade before now trying to disrupt them.

One of Apple's claims has been that this is just a dispute about how much they should pay for using our valuable intellectual property and that they have stopped paying because they don't know how much to pay us. This is quite obviously wrong. As I just explained, the longstanding and valid contract manufacturer licenses clearly specify the

royalties that are due and payable on Apple products, yet Apple is interfering with those contracts.

Further, we have made several offers to Apple to have an independent third party resolve the party's disagreement over the value of Qualcomm's technology and set the royalty terms of a direct license between Qualcomm and Apple once and for all. Apple has refused those offers each time, which shows they are more interested in pursuing a strategy of delay rather than good faith resolution. We will continue to vigorously defend the value of our innovation in our pro-competitive business model.

Turning to our data center business, we remain on track for commercial shipments of the Qualcomm Centriq 2400 processor family by the end of the calendar year, and we have already shipped more than 1,000 evaluation platforms to leading customers and partners. We continue to be very encouraged by the engagement with and feedback from a variety of our growing list of customers and partners as to the performance of our products.

In parallel, we are working hard to continue to build the data center ecosystem for Centriq-based servers. This quarter we announced a collaboration with Packet, a leading bare-metal cloud provider, to deliver a consumable cloud platform based on the Qualcomm Centriq 2400 processor for access by the software development community.

We demonstrated with Canonical a highly scalable OpenStack NFV infrastructure running on a Qualcomm Centriq 2400 platform. And we announced a collaboration with MariaDB to implement MariaDB's enterprise-grade data-based architecture on the Qualcomm Centriq 2400 processor to drive performance and compute at scale.

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

**George S. Davis** {BIO 3925391 <GO>}

Thank you, Derek, and good afternoon, everyone.

We are pleased to report a solid fiscal third quarter consistent with our revised expectations. Revenues were \$5.4 billion and non-GAAP earnings per share were \$0.83. Our results were above the midpoint of guidance, driven by better than expected QCT results on higher revenue and stronger margins.

QCT EBT margin was 14.2% for the quarter, at the high end of expectations, driven by favorable mobile product mix. We are continuing to see strong traction in QCT adjacent opportunities with quarterly revenues from these areas, in total, up approximately 30% year-over-year.

As a reminder, our adjacent opportunities include our chip sales into automotive, IoT, networking and compute. In QCT, MSM shipment were 187 million, up 4% sequentially and modestly below the midpoint of our expectation on softness in mid and low-tier devices.

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In QTL, revenues were \$1.2 billion, largely in line with expectation. Consistent with our revised guidance, the quarter was negatively impacted by our dispute with Apple as they instructed their contract manufacturers to not fully report and to not pay royalties due on sales of Apple products. In addition, we did not record QTL revenues from the ongoing dispute with the licensees that we disclosed last quarter as that entity did not report or pay royalties this quarter.

Non-GAAP combined R&D and SG&A expenses overall this quarter were up 6% sequentially, which was above our prior guidance of up 3% at the midpoint. Our prior guidance reflected the impact of a full quarter of the RF360 joint venture spending being included in our result. The increase in spend relative to our original expectation was driven by higher than expected litigation expenses as actions related to our dispute with Apple escalated and from accelerating investment related to pending 5G trials and related technology development. We believe these priorities are critical for value creation and preservation but are contributing to higher than modeled spending in the near term, which we will address as we get through this period.

Our non-GAAP tax rate for the quarter was 5%, reflecting the prior period impact of our revised April guidance of a full-year non-GAAP tax rate of approximately 14%. As a reminder, our effective tax rate is influenced by the mix of onshore and offshore earnings. The result of a lower mix of licensing revenues, which are onshore and tax at a full U.S. rate, is a reduction to our overall blended tax rate.

Turning to our balance sheet. In May, we issued \$11 billion of debt in the capital market. The funds from this offering will be used to finance a portion of our proposed acquisition of NXP and for general corporate purposes. With this financing, we have now completed our pre-funding for the NXP transaction.

We ended the quarter with cash and marketable securities of \$38 billion and total debt outstanding of \$22 billion. Our non-GAAP operating cash flow in the fiscal third quarter, which excludes the impact of the KFTC fine and the BlackBerry arbitration, was approximately \$2 billion or 39% of non-GAAP revenue. As a reminder, while the charge related to the KFTC fine was recorded on our income statement in our fiscal first quarter and the charge related to the BlackBerry arbitration was recorded in our fiscal second quarter, the related cash payments for both were made in our fiscal third quarter.

Through our fiscal third quarter, we have returned approximately \$3.4 billion to stockholders this fiscal year, including \$2.4 billion in dividends paid and \$1 billion in share repurchases. This is consistent with our continued commitment to the dividend program and dividend growth and our intent to repurchase shares to offset dilution.

Turning to our fiscal fourth quarter guidance, we estimate revenues to be in the range of approximately \$5.4 billion to \$6.2 billion, down approximately 6% year-over-year at the midpoint. Our revenue and EPS estimates exclude QTL revenues for Apple-related products and for the other licensee in dispute. We estimate non-GAAP earnings per share in our fiscal fourth quarter to be approximately \$0.75 to \$0.85 per share. We expect fiscal fourth quarter non-GAAP combined R&D and SG&A expenses will be up approximately



1% to 3% sequentially, driven primarily by increased litigation-related expenses and 5G investment.

As Derek explained, we are providing guidance for QTL segment revenues for the fiscal fourth quarter, which we expect to be in the range of \$1.0 billion to \$1.3 billion. We expect QTL EBT margin percentage to decrease sequentially and be between 64% and 68%, reflecting lower revenues at the midpoint and increased litigation-related expenses as we continue to defend our business model in various forms.

Turning to QCT, we anticipate MSM shipments in the fiscal fourth quarter of approximately 205 million to 225 million units, up 15% sequentially at the midpoint, driven by OEM product launches and continued traction with OEMs in China. We expect QCT EBT margin to be approximately 17% to 19% in the fiscal fourth quarter, increasing from 16.7% in the fourth quarter of fiscal 2016, favorable mobile product mix and growth in adjacent opportunities year-over-year.

For our Snapdragon 835 premium tier chipset, we expect supply of 10-nanometer to largely meet demand in the fiscal fourth quarter consistent with our prior expectations. We expect that interest expense will be up sequentially in the fiscal fourth quarter, reflecting a full quarter's impact related to the \$11 billion of debt issued in late May.

For fiscal 2017 overall, we now expect the combination of investment and other income and interest expense to be roughly flat versus fiscal 2016. Lower interest income year-over-year has been supplemented with gains on the sale of higher risk assets in our portfolio as we move into highly liquid short-term investments in preparation for funding the NXP acquisition.

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

Mike Walkley with Canaccord Genuity, please go ahead.

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

Thank you very much. I'm just really trying to get a clarification. So for the licensing dispute outside of Apple, can you just walk us through what, from that licensee, maybe was included in your Q3 results and what's excluded for Q4 guidance? Maybe you can help us on a sequential basis just on that licensee maybe in ballpark, the delta between Q3 and Q4. Thank you.

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

Hey, Mike. This is Derek. Yeah. So I think when we reported last quarter, we had some amount of revenue from that licensee in Q2 but it was an underpayment. They didn't pay the full amount. And we, at the time, had expected Q3 to include an underpayment but include some payment. And basically, the way things turned out, they did not report or pay anything for Q3 and that's consistent with the way that we have guided for Q4. So basically, both of the quarters exclude any revenue from the licensee that's in dispute.

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

Mike, hi. It's George. Let me just add to that. I think one of the things that we've seen people struggle with is the – there is no constant synthesis in the individual OEM. So, Q2 going to Q3 is typically a step down in the level of revenues, then you have a seasonal uptick picking up for Q3 and Q4. So, I think it's going to be hard to model a flat level of impact. And so, it's one of the reasons why in the guidance for this quarter, we guided QTL revenue overall because we understand using the old method of trying to get there from TRDS just can be too difficult.

**Operator**

Our next question is from Rod Hall with JPMorgan. Please go ahead with your question.

**Q - Rod Hall** {BIO 20453923 <GO>}

Yeah. Great. Thanks, guys. I guess I had one clarification and one question. So I wanted to, on that last question with regards to this licensee, it looks like, I mean, at QTL, your guide is deviating another \$100 million from what we were forecasting. And even though I get that you guys don't want us forecasting or it's hard to forecast using the old methodologies. Most of our models don't run that way. So, I'm just wondering can you give us any idea whether the full withholding of payments from that licensee is in the ballpark of, say, \$250 million or something like that just so we can think about what the deviation from our model looking forward might be?

And then, this – the real question I've got is on the European review of NXPI. That's moved to a full review. Can you – Derek, could you just give us any color on what is happening there? Why reportedly, anyway, you guys have not – decided not to go along with remedies that have been suggested and now, were into a more detailed review. Was that always the expectation in Europe or has something changed in regards to your discussions with the regulators there? So, could you just give us a little bit more color on what's happening there? Thanks.

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

Sure. Hey, Rod, let me comment. I think one of the things I would remind people as they look at, particularly the year-over-year comparison for the licensing business, both in Q3 and Q4 comparatively, we saw good market, underlying market in both of those. So, the – there's no – the – any shortfall in your estimates are not really related to the market. What we saw is there was catch-up from the settlement of Chinese agreement in Q3 and Q4 of 2016 that are impacting year-over-year comparisons.

And so one of the things that the models would need to show is the lower catch-up in Q4 of 2017 relative to 2016. And then the rest is really just Apple and the other licensee and the impact of the specific dollars related to those OEMs. But those are really the only factors impacting the underlying estimates.

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

Hey, Rod, this is Derek. Let me just add that our practice historically has been not to disclose the identity of licensees when we're trying to resolve a dispute and it hasn't has yet gone to litigation, and so we're going to go ahead and stick to that practice. And so we're not going to give specific color on the amount of underpayment coming from any particular licensee.

I think one of the things just to think about in terms of modeling, we have had catch-up payments flowing through QTL from prior period, sort of quarter to quarter. We said that's going to be lumpy and it will be hard to predict in coming over time. And there were some, of those amounts, meaningful amounts in Q3. But I would say the midpoint of our guide for QTL revenue in Q4 doesn't really include a significant amount of that, so that may be another deviation when you look at your model.

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

And, Rod, this is Don. I'll take your question about NXP in Europe. There's not a lot to say about that at all. The Phase I process, as you know, is fairly short. We're dealing with a significant acquisition here with both a U.S.-based company and a major European-based company, so it's not surprising that we move into Phase II. We're engaged in Phase II. We will listen to any concerns that maybe expressed, and we'll respond to them we think within the time period that should be the normal run of the Phase II process. Obviously, can't predict but we're very optimistic about our ability to continue to demonstrate the complementary nature of this acquisition. And with four regulatory approvals already, we think we're on a pretty good track here.

**Q - Rod Hall** {BIO 20453923 <GO>}

Great, okay. Thank you, guys.

**Operator**

Our next question is from Kulbinder Garcha with Credit Suisse. Please go ahead with your question.

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

Thank you. My question is for Derek as well. Just on the dispute with the licensee, it's not, just to be clear, it's not like a regular audit type but just a fundamental disagreement on both parties in terms of how the licensing agreement you have with them is being interpreted, so this may last for some time. Is that the right way of thinking about it?

And the second question is, in a world in which the smartphone market in revenue terms is really not growing very much, let's say, 2% or 3%, if Apple do gain meaningful market share in the next two years, is it reasonable to assume that even this licensing run rate would contract? Are there other drivers that we should think about? I'm just thinking there's obviously a super-cycle coming of single payers, and Apple getting a lot of share in the industry really doesn't grow that much, then basically, you're exposed to a decline coming until this is resolved. Is that the right way to think about it?

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

Hey, Kulbinder, this is Derek. I think on the first one, I would characterize it this way. The dispute we have with this licensee is a dispute over the terms of their agreement. Not too dissimilar to ones that we've had in the past, they've resolved themselves in a variety of different ways historically. Some of them - most of them, frankly, we've been able to resolve through some period of negotiation. We're still in that phase with this licensee.

And then you might recall back even just most recently with LG, that did escalate through an arbitration, but then we were able to resolve it fairly quickly even after the arbitration was resolved. So I don't think we can predict with any certainty the exact timing, but I don't think it's a foregone conclusion that this will be something that takes a long time to resolve either. I think it's highly dependent on the circumstances.

I think you might have some - let me try to reframe the second question. Our view, and I'll give you some data points to support this, is that the license business has the ability to continue to grow with the end market. We see end market growth continuing going forward once we have these disputes resolved. And I think even if you looked at this quarter, we would have seen year-over-year growth in the licensing business if you adjusted for all the anomalies of the disputes and some of the one-time payment. But if you step back and look longer term at the end market, the units continue to grow in line with our projections last year. Unit growth was about 10%. In our current forecast which we're holding in calendar 2017, it's about 6% unit growth. And you combine that with the moderating declines in ASPs, and we still believe that TRDS independent of any particular OEM, so even if Apple were to gain share, is something that will grow in the mid-single digits.

And I think the thing that's been very positive for us this year is that ASPs probably are moderating. The ASP declines are moderating even more than we expected, meaning the declines are less than we would have expected going into the year. And that's largely being driven by strength in China as well as increasing ASPs by many of the Chinese OEMs as they build their businesses outside of China, which are a couple of the important trends that we highlighted starting two or three years ago of why we believe we would see long-term growth in the market.

So again, if you wrap that all up, end market will continue to grow. We think it can continue to grow meaningfully and we think, once we get through these disputes, we can continue to grow the licensing business in line with that.

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

Thank you.

## Operator

Our next question is from Simona Jankowski with Goldman Sachs. Please go ahead with your question.

### Q - Doug Clark {BIO 18873977 <GO>}

Thanks. This is Doug Clark on behalf of Simona. One follow-up question to kind of the historical context of disputes with some licensees. Putting all of those together, is there any generalization or kind of rule that you've come to notice as a result of the resolution of these disputes that they've either resulted in kind of deflationary to the royalty rate or if, in certain cases, you've been able to hold those royalty rate constants? I'm wondering if there's kind of any conclusions that you've drawn from those.

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

Doug, this is Derek. It's pretty hard to answer in kind of a high level. I think each individual deal is different. I would say, through any of the negotiations and dispute resolutions, we - I think we've been successful historically in obtaining what we believe is a fair value for the portfolio. Some of those deals have taken different forms and different structures over the years but I think, by and large, that's sort of the principle that we operate by. It's the same principle that we operated by as we resolve the remaining agreements we negotiated in China over the last couple of years, and it's really the same principle that we'll be applying to our dispute with Apple as we look for trying to achieve the right long-term agreement for the company and consistent with the value of our intellectual property.

### Q - Doug Clark {BIO 18873977 <GO>}

Okay. Got it. And then, my follow-up question is as we move to kind of the key marquee product launches, particularly the upcoming iPhone, have any of the disputes, in your opinion, had any impact on how share will shake out from a chipset standpoint?

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

Hi, Doug. This is Cristiano. Look, I think we have said, I think, in the things go back in time that we have planned for multi-sourcing. And I think at this point, I think what we see, we'll continue to be engaged with them on the product side. We feel very confident about, I think, the capabilities of our product. I would argue that generation to generation, our differentiation is actually increasing. And right now, we continue to receive orders from the CMs. So I don't think we can at this point identify anything different than what we have been expecting.

### Q - Doug Clark {BIO 18873977 <GO>}

Got it, thanks.

## Operator

Our next question is from James Faucette from Morgan Stanley. Please go ahead with your question.

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

Great, thank you very much. Quickly, Don, I know you touched on (39:48) view of the NXPI acquisition. Can you just give us a recap of the regulatory bodies that you still need to hear from and an outline of when you - when we should expect to get feedback from them?

And then, maybe, Steve, a question for you, can you talk about how, since the NXPI acquisition was announced or the intention to acquire NXPI, how is your conversation with this opportunity with customers and the opportunities outside the (40:21) business have been evolving and the partners you've been able to make you in before NXPI closes? Thanks.

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

Hi, this is Don. So on your NXP question, to remind you, there were nine jurisdictions originally that had to approve. We've, as I said, had four approved: U.S, Mexico, Russia and Taiwan. Those that are left are the EU, China, Japan, South Korea and the Philippines. We are proceeding in each case by engaging with the regulatory bodies in each jurisdiction.

We are, we think, on track in terms of following their processes. And as we've indicated and Steve indicated earlier, we expect that the timeline, as we've outlined it, will continue and we're shooting for the end of 2017. And I don't think there's really much to say about those other regulatory bodies other than that. As I said, we're cooperating with them and haven't seen any issues at the moment.

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

James, this is Steve. I would say the discussions with the customers have been good. Obviously, we have limitations into the degree to which we have discussions given that we are pre-closed but I've been pretty pleased with what we're hearing with respect to the industrial logic behind the deal. So some of the, I think, the bringing together of the Qualcomm IP roadmap and technology roadmap to the channel of - and the broader portfolio of products in auto has been, I think, positively received by the customers as far as my discussions.

And I think, also, the importance of increasing the scale and the channel in the IoT space is definitely being validated in terms of our view of the market. And I think, also, if you look at the last two quarters of the product business here for us, it really seems to be headed in the same direct - or headed in a way that is consistent with the industrial logic behind the acquisition, which is that as things get connected, you're going to start to see more overlap in terms of the required technology to cross these businesses. And I think that's actually good for the end markets and we've been hearing comments consistent with that from the customer.

So we're planning for the - actively planning for the integration and working through the regulatory issues and moving quickly toward closing at the end of the year or before the end of the year.

## Operator

Our next question is from the line of Tim Long with BMO Capital Markets.

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

If I could maybe switch over to the chip business. George, you mentioned in the guidance for MSM next quarter some product launches and China strength. It's a little bit more - stronger than normal seasonal. So could you talk a little bit about where - was inventory a little low heading in? China has been a pretty tough end market so far this year. So, do you think there's going to be a turnaround in the business there or is this market share? Is it more exports? So, maybe talk a little bit about that strength and maybe sustainability. And then, related to that, I would assume that we might be up for a little bit weaker of MS - of ASP calculated in that division in the September quarter? Thank you.

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

Hi, Tim. This is Cristiano. Look, I think it's probably important to understand the trends in China market. China has been a growth and a strong story for us and I think we see that continuing.

So first, to your point about what we saw about the product mix. I think we see the market moving up and we see that consistently. We saw that as the market matures, the tiers on the devices, we see higher growth rates in the higher tiers than in the lower tiers. And I think Snapdragon 600 and Snapdragon 800 are doing very well, in particular, the Snapdragon 600 has been a very good story for us.

When you asked about the going forward, I'll maybe remind you, we - we've said in the past about things like All Mode and carrier aggregation. Now, 70% of every single device in China is All Mode. 4G Plus is now well understood by consumer as a carrier aggregation. And we see things moving towards higher speeds both on our integrated WiFi as well as cellular leading to gigabit LTE. And I think 5G is likely going to be one of the largest market as China will not want to be behind all the other economies. So, I think the story in China is very good.

And your last point about growth, we saw the top 10 Chinese OEMs which, I think, where we are very well-positioned going aggressively outside China. And I think that is enabling our China business to grow faster than the market. Thank you.

## Operator

Our next question is from the line of Ross Seymore from Deutsche Bank. Please go ahead with your question.

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

I had two questions. The first one on the OpEx side of the equation, George, obviously, the litigation coming in makes sense as to why the spending will be a bit higher in the quarter in the guide. But the other side of the equation, the 5G acceleration, can you talk a little bit about the sustainability of that? Is it going to last for a couple of quarters, and then, fall off? So generally, the strategy behind that.

And then, the second question I had was on the NXP deal. The regulatory environment, a lot of people have asked about that roadmap, but I'm receiving a lot of questions with people debating that the price that you paid, given the move in the semiconductor market, may appear to be low. So, I was wondering if we can just get your thoughts on the price that you guys have agreed upon with NXP.

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

Ross, let me start with the OpEx question. Clearly, as you said, we're escalating the activity with respect to litigation. And so, that you'll continue to see growth in the spend there. But on the 5G side, and I may have Cristiano add some thoughts on this as well, we're seeing a pulling of activity by customers and the number of trials increasing and we feel it's very important to be seen and continue to be seen as leading those activities. Of course, and on top of that, that just means that the roadmap for 5G is getting pulled in more rapidly.

So, it's not clear to me that that - this is a one or two quarter type event. I think we're going to see some elevated spending here over the next year to two as we get through these 5G trials and the beginning of commercial 5G launches.

I'll stop there for a minute and Cristiano, if you want to add something.

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

All right. I'm just going to say that I think more and more, we see 2019 as a reality for 5G commercialization.

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

Great, thanks. And then, on the NXP deal, I'll just reemphasize, our focus is really on the regulatory matters and getting those closed out along with the integration planning. And we're confident we're going to go ahead and close this on the terms that we've agreed to by year end.

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

All right, thank you.

**Operator**

Our next question is from the line of Tal Liani with Bank of America Merrill Lynch. Please go ahead with your question.



**Q - Tal Liani** {BIO 1643846 <GO>}

Hi, two questions. First, puts and takes, if you can discuss puts and takes of gross margin of QTL next quarter and is there anything outside of lower revenue level in the litigation expense? That's number one.

And then, the second question is, now you lost big QCT business with your largest customer, Apple, you lost, there are some disputes with one of your largest customers on licensing. And the question is, does it make more sense now to break up the company into two pieces or you're in the same position as before? I want to understand if you think there is any correlation between your ability to maximize the value of each segment separately in light of the disputes and these arguments with customers? Thanks.

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

Tal, it's George. What you're seeing in the gross margin effect or really the margin effect that we guided for QTL is really revenue and revenue coming down based on these disputes that we've discussed. Actually, the market is quite healthy, so all the other dynamics are very attractive. And then, the fact that we're ramping spending into that lower revenue for litigation matters.

So, it's a combination of the two just pulled the margin down. It's not like a product business where you have a variable cost as revenue comes down where your costs come down. So this is one where, until we get through this period of higher litigation spending and the dispute period, you'll see lower than historic, but the fundamentals behind the business outside of these disputes are quite attractive.

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

Tal, this is Steve. With respect to the business structure, I think we've looked at it pretty heavily in the past, and it's still an area that we look at as the environment changes and we're making sure that we're putting the business in the right place to maximize value. But at this point, I think we feel like we have the right structure to resolve this dispute as well as to position the business for the future in terms of the transition into 5G as well as the growth into driving the cellular roadmap into new technology areas or new end opportunities. So again, we look at this from time to time, continue to look at it as a way to maximize value, but I think we feel like we have the right business structure to resolve this.

**Q - Tal Liani** {BIO 1643846 <GO>}

Thank you.

**Operator**

Our next question is from Stacy Rasgon with Bernstein Research. Please go ahead with your question.

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

Here are my questions. First, regarding this other licensee dispute, is it safe to say that this other dispute is not with a Chinese OEM given that you've already settled with the large Chinese OEMs, or is that not a leap of logic that it would be appropriate for me to make?

Secondly, given the escalation here and given everything else that's been going on, how do we gain conviction that we don't see further contagion, further spreading of this to other customers, given this seems to be bleeding out across the rest of your business?

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

Stacy, this is Derek. As I said in response to an earlier question, we are not going to at this point disclose the identity of the licensee that we have the dispute with. So I'm not going to comment on that one further.

I think on the question of contagion, if you think about it, we're working very hard across a number of fronts to really stabilize the regulatory environment, and that remains a priority for us. Historically, we've had disputes with licensees large and small, going back all the way to even with Nokia where they had 40% to 50% of the market and were not paying us for a period of time, and that did not translate into our other licensees stopping payment. That's just one data point, but as we sit here, we're focused on resolving the issues we have, the current dispute with this licensee beyond.

Apple is focused on their agreement. It's a contract dispute under their agreement, and we're going to focus on getting those things resolved. And I don't think, as we sit here, we have any indication that that this is somehow going to result in a bunch of other licensees deciding not to report and pay royalties.

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

But you never have any indication, do you?

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

You never know what you never know. But I'm saying historically, if you look at it historically, we haven't had that problem. As we've had disputes, we've been able to work through to resolve them without other licensees necessarily just deciding they're not going to comply with their agreement. So I think that's the best we can tell you at this point.

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

But that's exactly what's happening right now, isn't it?

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

No, that's not what's happening. We have a dispute with Apple and their contract manufacturers and we have a dispute with one other licensee.

**Operator**

Our next question is from the line of Vijay Rakesh with Mizuho. Please go ahead with your question.

**Q - Vijay Raghavan Rakesh** {BIO 5884146 <GO>}

Thanks, guys. Just going back on that other licensee, am I to understand that in the event of a partial nonpayment or full nonpayment for the next quarter, is that already assuming in the guide? And on the Apple side, with the new litigation that you announced, which is non-spend IP, can you give us some timelines on that or does that stand? Thanks.

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

This is George. I'll take the first question. Our guide in Q3 assumed a partial payment which we did not receive, and we assume no payment or report in Q4 guidance.

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

And this is Don. I think you're referring to the two cases - or three, two in the U.S. that we've brought and one recently in Germany. As we've said before, the ITC case in the U.S. generally takes about 18 months, so we're hoping it will stay along that timeline. The cases in Germany could go as quickly as one year. But obviously, every case is somewhat different, but that's a good estimate, I would say.

**Q - Vijay Raghavan Rakesh** {BIO 5884146 <GO>}

All right, thanks.

**Operator**

Our next question is from the line of Romit Shah with Nomura Instinet. Please go ahead with your question.

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

Thank you very much. George, I just wanted to follow up on Ross's question regarding the NXPI deal. With semiconductor stocks just sort of broadly up 30% to 40% since you announced your intention to buy the company, there has been uncertainty more recently on just whether or not you'll get the 80% approval. And I know you're confident, but I'm just curious. How does the process work if you were to reevaluate your offer price? Would you only do so after the shareholders have voted, or does it work differently?

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

Romit, I'll just repeat. Really, our focus is on getting through regulatory and getting prepared for the close at the end of the year. I think everything else here is just speculation, and I'm not going to comment further.

**Operator**

Our next question is from the line of Tavis McCourt with Raymond James. Please go ahead with your question.

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

Thanks for taking my questions. I have a couple. First, I wanted to make sure that the closing of the TDK joint venture, did the June quarter have a full quarter of revenues and cost from that, or was that just partial?

And then, Derek, I think you mentioned in the answer to a previous question that there were some catch-up payments in the Q3 QTL revenues. Can you dimensionalize that or give us an indication that if you back those out, it would be pretty similar to the Q4 guide?

And then a question I guess for Steve. I think there was a lawsuit threat by Intel during the quarter related to Windows 10 and x86 emulation, and I'm just wondering. Has it moved beyond the threat, and does it change your opinion on that end market opportunity for you? Thanks.

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

For the third quarter, we had a full quarter of the TDK joint venture.

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

Tavis, this is Derek. On the catch-up payments, for Q3, I don't think we gave a specific number. They were meaningful, and I think the way to think about the guide on Q4 is that the midpoint for the QTL revenue guidance doesn't have a significant amount of catch-up. So if you look at it quarter over quarter, Q3 to Q4, relatively flat based on our guide. But you're coming off a Q3 that had some meaningful catch-up in it.

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

And with respect to the lawsuit, and I think it was actually just a press report that I had heard, and I think if anything, if I remember correctly, it wasn't directed towards us. It was probably directed toward the customers and the ecosystem involved in the PC space. We haven't heard anything about that since then.

I will say that we are actively engaged with customers who are interested in that opportunity and that opportunity is coming here per the schedule that we gave in the past. So, it's - I think it's building some excitement and we're pretty excited about what we're seeing there.

**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>}

FINAL

Yeah. Thank you. First of all, I just want to thank all the employees for their hard work and maybe I'll finish up with four final thoughts. The first one is given the environment that we're in, I just want to recognize and thank everybody for the strong results on the product side. It's really an indication of the strategy playing forward and we're pleased to see the results here in the business.

Second one is the timing of NXP is on track and I think building momentum and looking forward to that happening.

We mentioned that, on the third point, that we're - we believe we have the high ground on Apple in terms of our legal dispute. We obviously ask for some patience in terms of us getting through that. But we do feel good about our positioning there and we hope to be able to report people or be able to provide status as we move forward.

And finally, I just want to acknowledge the team for putting together a great roadmap and this is showing up, not only in the results but also in some of the 5G excitement.

And with that, I'll just close and look forward to talking with you all next quarter. Thank you.

## Operator

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

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