Company Name: Qualcomm
Company Ticker: QCOM US
Date: 2017-01-25
Event Description: Q1 2017 Earnings Call

Market Cap: 84,043.64
Current PX: 56.90
YTD Change($): -8.30
YTD Change(%): -12.730

Bloomberg Estimates - EPS
Current Quarter: 1.190
Current Year: 4.737
Bloomberg Estimates - Sales
Current Quarter: 5893.850
Current Year: 23929.320

Q1 2017 Earnings Call

Company Participants

- John T. Sinnott
- Steven M. Mollenkopf
- Derek K. Aberle
- George S. Davis
- Cristiano R. Amon
- Donald J. Rosenberg

Other Participants

- T. Michael Walkley
- Simona K. Jankowski
- James E. Faucette
- Timothy Patrick Long
- Rod B. Hall
- Timothy Arcuri
- Stacy Aaron Rasgon
- Kulbinder S. Garcha

MANAGEMENT DISCUSSION SECTION

John T. Sinnott

GAAP and Non-GAAP Financial Measures

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

Steven M. Mollenkopf

Q1 Highlights

Revenue and Non-GAAP EPS Growth

- We delivered a strong quarter, with revenue and non-GAAP EPS growth of 4% and 23% y-over-y respectively, reflecting strong results of technology leadership and disciplined execution in our core mobile businesses
- Before discussing our business activities further, I would like to first comment on the recent legal challenges facing Qualcomm
  - This is something we take very seriously and will cover in depth today
- But before that, let me say that historically, we have had a strong relationship with Apple, and they have been a longstanding and valued customer

Apple

- We intend to remain a good supplier to Apple, even while this dispute continues, and believe there is no better long-term partner for Apple than Qualcomm and our industry-leading technology
- We believe that our strong and highly differentiated product roadmap will continue to be the foundation for our relationship and covers a broad range of technologies that will be fundamental to new products for years to come
- Our preference is always to resolve customer disputes through negotiation instead of litigation, so it is regrettable that Apple has chosen to take this path
  - We are well prepared and confident in our ability to successfully defend against Apple's claims as well as the related regulatory matters in Korea and with the FTC

Licensing Program

- Apple's complaint contains a lot of assertions
- But in the end, this is a commercial dispute over the price of intellectual property
- They want to pay less for the fair value that Qualcomm has established in the marketplace for our technology, even though Apple has generated billions in profits from using that technology
- Qualcomm has always been and remains a systems innovator and R&D engine for the mobile industry
- Unlike virtually every major company in our industry, sharing technology broadly with the industry through our licensing program has always been a paramount aspect of our business model along with enabling competition
- Our inventions have fundamentally enabled the mobile industry
- And while those contributions began more than three decades ago, we continue to invest heavily and lead the way in 4G LTE technology and mobile computing, and we are now leading the industry to 5G

Patent Portfolio

- And, although the initial market value of our portfolio was established a long time ago, that value has tangibly and meaningfully increased over time as our technology contributions and our patent portfolio have grown significantly, yet we have never raised our royalty rates
- This established value has been reaffirmed time and time again as we have renegotiated existing licenses and entered into new license agreements with numerous licensees over the years, including over 120 new licenses in China within just the last two years

Business Model

- As many of you on the call today are aware, we have a long history of successfully defending our licensing practices and business model, which have been tested around the globe, most recently in China
- The resilience of our practices reflects both the fundamental and differentiated contributions we make to the core technologies enabling the smartphone platform and the mobile industry as a whole
- We invest heavily to push the technology boundaries for the benefit of our licensees and their customers and the industry as a whole, and their licenses become more valuable and comprehensive over time

IP

- We out-innovate and out-invest other players in mobile and have negotiated and signed more than 200 license agreements, which validate and recognize the value of our technology contributions and related portfolio of IP
- At the same time, I believe we have more opportunity ahead of us than at any time in the company's history
- And I assure you that our teams remain focused on executing on those opportunities, which when realized will provide the next significant growth period for Qualcomm, with an estimated $138B serviceable addressable market in 2020

Pending Acquisition of NXP

- Our pending acquisition of NXP is reflective of and consistent with these opportunities
- This highly complementary combination accelerates our scale and portfolio of products and technologies as well as expands our go-to-market channels in the growth segments of automotive, IoT, security, and networking
- We are seeing very strong support for this transaction in our conversations with customers and look forward to realizing the full potential of bringing the two companies together
- We are progressing on our regulatory filings for the NXP transaction and integration planning is well underway

Joint Venture with TDK

- Another important opportunity comes with the formation of our joint venture with TDK
- We are concluding 12 months of preparation and expect to close the JV this quarter
- I believe this JV will transform our activities in RF front-end from a strong niche player to a truly formidable challenger competing with all the necessary technology blocks to build our presence in that space

Snapdragon Platform

- I am also excited about our recently announced program with Microsoft to bring Snapdragon to mobile compute
- This allows us to bring the advantages of mobile innovation, leading consumer electronics technologies, and conductivity of the Snapdragon platform to laptop PCs and expand our participation in a serviceable addressable market opportunity expected to be $6B in 2020
- As another example of our ability to expand our computing presence, our data center business also continues to execute well, as Derek will explain in more detail in a moment

CES

- I would like to thank the Qualcomm team for a strong showing at CES
- Our newly announced Snapdragon 835 sets new standards for the next generation of smartphones, computing, VR and AR, and many other applications, and we are leading the semiconductor industry in 10-nanometer technology
- We also continue to set new bars in modem technology, including our new X16 Gigabit LTE and X50 5G modems
- Simply stated, the roadmap is as strong today as it has ever been

Summary

To summarize, we are very excited about the future and the many opportunities directly in front of us

This is a truly transformative time in the company's history

I am confident we will address and get through the legal challenges underway, as we have done many times in the past

And in the meantime, I am pleased to see our results reflect strong execution in both our major businesses

Derek K. Aberle

Q1 Highlights

Performance

- First, I'd like to build on Steve's earlier comments regarding Apple's recent legal claims
- Not only are Apple's claims without merit, but they attempt to undermine the standards-based agreements that have been the backbone of the mobile revolution, the framework that has facilitated and motivated a small number of companies like Qualcomm to make investments to develop new technology as well as the products and infrastructure to support that technology

Global Mobile Technology Ecosystem

- The cornerstone of the global mobile technology ecosystem and the success of so many industry participants are based on the notion that companies that are willing to invest the necessary capital and devote engineering talent to invent technologies long before they can ever be implemented be fairly compensated for sharing those inventions through licensing
- At Qualcomm, we have spent billions of dollars and have continually focused on inventing the breakthrough technologies that have fueled the mobile revolution and enabled multiple generations of technological innovations in smartphones and other connected devices
- Our industry leadership today comes from making these significant focused investments ahead of the industry over many years to create leading technology

Inception

- From our inception, Qualcomm has been at the forefront of the industry, imagining, inventing, and commercializing the fundamental technologies at scale that brought high-speed mobile data and computing to a global mass-market reality
- It is Qualcomm which drove the development of ubiquitous cellular connectivity in mobile computing, including increasingly higher data rates and spectrum efficiency as well as more powerful and efficient mobile computing solutions that enable the key features and functions of smartphones and which are making consumers' lives better, connecting billions of people to the Internet for the first time, and enabling countless new businesses and industries

Business Model

- Our technology has enabled the mobile economy and the foundation for business models and applications of companies like Uber, Snapchat, Instagram, messaging apps like WhatsApp and iMessage, streaming services like

Spotify, smart assistants like Siri and Google Assistant, and many others across the globe

GPS

- Our innovations in assisted GPS have also led to location-based services, real-time mapping, and navigation service on which hundreds of millions of people around the world now depend
- This mobile application revolution was enabled directly by Qualcomm's business model of inventing and broadly sharing through licensing our key technologies with hundreds of companies in the mobile ecosystem

Smartphone

- Without our technology, our investments, and our innovation, the mobile world today would not be nearly as disruptive, efficient, or useful
- Qualcomm led the industry in producing innovations that provide or support almost every aspect of your smartphone's capability
- And Apple has been among the largest beneficiaries of our efforts and investments by being able to easily enter the smartphone space with little to no investment in the core technology
- Apple has utilized our technology as the foundation for becoming the most profitable smartphone supplier in the world

LTE Network

- Apple's own marketing statements recognize the value Qualcomm technology contributes to its products
- For example, Apple recently acknowledged that the rollout of LTE networks in India will be the transition that unleashes the power and capability of the iPhone in India
- As the leading innovator in 4G LTE, we agree

SEPs

- Touching briefly on Apple's complaints filed in San Diego and China, it claims that Qualcomm should be required to license its cellular standard essential patents, or SEPs, to modem suppliers, and that even when licensing those patents at the device level, Qualcomm should only be able to charge royalties on the price of the cellular modem chip inside the device
- These positions, however, are inconsistent with longstanding industry practice, the IPR policies of the relevant standards-setting bodies, the realities of licensing large portfolios of patents, and basic notions of efficiency, fairness, and economics

ETSI

- First, Qualcomm and many other major patent holders have long followed the practice of licensing portfolios of SEPs at the device level, including for 3G and LTE
- There has been no sudden change in the law to make this practice improper, and it remains the most efficient and fair method of licensing

- Second, neither Qualcomm's licensing commitments nor patent law requires Qualcomm to license its SEPs at the component level or charge royalties on the modem chip within a smartphone
  - There was an attempt by Apple and others to modify the IPR policy of ETSI [European Telecommunications Standards Institute], which governs licensing commitments for cellular SEPs, to include these concepts, but that effort failed

Cellular SEPs

- Third, Qualcomm has a vast technology patent portfolio that is broadly applicable to the technology and features implemented in smartphones
- Focusing on just our cellular SEPs, which is a subset of our overall patent portfolio, only a small percentage of the claims in those patents are implemented entirely within a cellular modem chip
- So even if Qualcomm were to license that subset of its cellular SEPs to a modem chip supplier, the device supplier using that chip would still need to take a license to the remainder of our cellular SEPs and other patents

Multi-Level Licensing

  - Engaging in licensing at multiple levels creates significant inefficiencies with no tangible benefits, and the established value for a portfolio of patents like Qualcomm's does not change by moving from device-level licensing to multi-level licensing at both the modem chip and device levels
  - Finally, Apple claims that Qualcomm's licensing terms would require Apple to pay higher royalties whenever they add new features that they claim have nothing to do with Qualcomm's technology or intellectual property
  - As I just explained, Qualcomm's mobile technology enables the applications and functions that Apple highlights

Licensing Program

- In addition, it is well known that Qualcomm has per-unit running royalty caps as part of its licensing program
- This effectively results in licensees not paying running royalties as a percentage of the device price above a certain net selling price of any given device
- Apple's claim that royalties are uncapped is simply incorrect
- Licensing at device level provides the licensee with the certainty that it has the rights needed to design, manufacture, and sell devices regardless of which components within the phone implement the patents or whether the component supplier has a license for those patents
- Charging royalties as a percentage of the device price is fair and consistent with the fact that lower-priced devices tend to use and rely upon less of the licensed technology than the more expensive fully featured devices

KFTC

- The recent KFTC [Korea Fair Trade Commission] decision, the U.S. Federal Trade Commission complaint, and the filing of Apple's complaints are not coincidental in terms of content and timing
- Apple has been actively driving regulatory attacks on Qualcomm's business in jurisdictions around the world and misrepresenting facts and withholding information
- Apple claims that Qualcomm retaliated because Apple cooperated with government investigations

- To be clear, we did no such thing
- We simply objected to Apple making false and misleading statements and withholding information to motivate attacks against Qualcomm
- We welcome the opportunity to have Apple's claims heard in court, where we will be entitled to full discovery of Apple's practices in a robust examination of the merits
  - We will prove that Apple's irresponsible claims of extortion are false

Korea-U.S. Free Trade Agreement

- With respect to the KFTC decision, in December it announced that it intends to issue a corrective order and impose a fine
- As we said last month, this is an unprecedented and unsupportable decision, inconsistent with the facts and the law and representing a clear violation of due process rights under the Korea-U.S. Free Trade Agreement

Seoul High Court

- We recently received a written decision from the KFTC and will be appealing the decision and seeking a stay in the Seoul High Court, which we expect will rigorously analyze evidence and apply sound antitrust principles
- It should be noted that the KFTC usually takes some number of months to go from a post-hearing decision to a written final order
- Here the KFTC completed a very lengthy written decision in less than a month's time, which is further evidence the KFTC hurried to judgment without regard to the merits of the case

Apple

- With respect to the FTC complaint filed last week, as we outlined in our press release, it was a split decision taken in the last days of the Obama administration and is very focused on Apple, which filed its related case just days later
- It is based on a flawed legal theory, a lack of economic support, and significant misconceptions about the mobile technology industry
- It is also very important to note that FTC Commissioner Maureen Ohlhausen voted against filing the complaint and went so far as to issue a strong dissenting statement

Business Model

- We look forward to vigorously defending our business
- We have faced legal challenges to our business model over the years given the powerful commercial interests that play, but there is clear evidence of vibrant competition across the mobile industry, and this environment is enabled by our broad pro-competitive licensing program
- We expect and look forward to outcomes that confirm the valuable contributions to innovation and competition that our technologies bring

- Apple's attack on Qualcomm's business model is not only an attack on Qualcomm, but also an attack on the smartphone competition that Qualcomm's business model enables

QTL

- Shifting gears, as Steve noted, QTL had a strong first fiscal quarter, as we continued to make very good progress signing new license agreements in China, including the complete resolution of our outstanding legal issues with Meizu
- QTL revenues were $1.8B, up approximately 13% y-over-y, driven primarily by favorable trends in China, including handset sales growth and licensing and compliance progress in the region, as well as strong growth of global sales by Chinese licensees

Sales

- Total reported device sales in the fiscal first quarter were $62.9B, above the midpoint of our prior guidance
- And we estimate that reported 3G/4G device shipments were 330mm units, with an ASP of $189 at the midpoints

Xiaomi and Meizu

- After the end of Q1, we completed licensing agreements with both Xiaomi and Meizu, and have now completed agreements with all of the top 10 Chinese OEMs according to IDC
- To date, we have completed agreements with more than 120 manufacturers in China, consistent with the NDRC [National Development and Reform Commission] terms
- We estimate that we are now collecting royalties on approximately 80% of Chinese OEM global 3G/4G device sales
    - We remain focused on improved compliance and completing additional agreements, which could provide upside to our estimates

Global 3G/4G Device Shipments

- Turning to global 3G/4G device shipments, for calendar 2016 we estimate 1.65B to 1.7B devices were shipped, up 8% y-over-y at the midpoint and in line with our prior forecast
- For calendar 2017, we continue to expect approximately 7% growth y-over-y, with global 3G/4G device shipments of 1.75B to 1.85B devices, driven by demand in the emerging regions

Global ASP

- We estimate that global handset ASP in FY2016 was approximately $185, down approximately 6% y-over-y, consistent with our expectations and well below the 12% decline in FY2015
- We continue to expect that the annual decline in the global ASP for handsets shipped during FY2017 will further moderate as compared to FY2016 despite FX headwinds
- You may recall that a few years ago we forecast that global handset ASPs would go through a period of accelerated erosion for a couple of years, and then those declines would moderate over time
    - We are seeing those trends play out as we predicted

- We expect total reported device sales from licensees in the second fiscal quarter to be approximately $74B to $82B, up approximately 24% sequentially and 11% y-over-y at the midpoint, driven primarily by the busy holiday December quarter shipment activity and reflective of increased licensing and compliance progress

Data Center Business

- In our data center business, we achieved a key milestone, as we announced the commercial sampling and conducted a live demonstration of the world's first 10-nanometer server processor, and early customer feedback and testing have been encouraging
- As the first in the Qualcomm Centriq product family, the Qualcomm Centriq 2400 Series has up to 48 cores and is built on the most advanced 10-nanometer FinFET process technology
- It features the Qualcomm Falkor CPU, Qualcomm Datacenter Technologies custom ARMv8-compliant core, which is highly optimized to deliver both high performance and power efficiency and designed to tackle the most common data center workloads

China

- In China, we also have made great progress with our data center joint venture, which is now busy developing a customized server CPU product based on our technology and designs for the China market
- Although we have several ongoing challenges to our licensing program, we are confident in our positions
- And we believe we will come out of these challenges stronger as a company in the end, as we have done many times in the past

George S. Davis

Q1 Highlights

Revenue and Non-GAAP EPS

- Fiscal first quarter results were in line with our outlook with revenues of $6B and non-GAAP EPS of $1.19, $0.02 above the midpoint of our guidance range, driven primarily by performance in our licensing business

QTL

- In QTL, revenues were $1.8B and total reported device sales by licensees were $62.9B, just above the midpoint of our guidance, driven by stronger ASPs in developed regions
- Q1 results for QTL exclude contributions from the recently signed license agreements with Meizu and Xiaomi, which we expect to start benefiting QTL in fiscal Q2

QCT

- In QCT, MSM chip shipments were 217mm, modestly above the midpoint of our guidance range
- Overall performance was in line with expectations, and we had strong contributions from our adjacent areas, including IoT, wireless networking, and auto

- QCT's earnings before tax was up 23% vs. the first fiscal quarter of 2016, reflecting strong demand for our new products, growth in adjacencies, and an improved cost structure
- QCT operating margin was approximately 18% for the quarter, up more than 300BPS over the same period last year

R&D and SG&A Expenses

- For the company, non-GAAP combined R&D and SG&A expenses increased by less than 1% sequentially, modestly above our prior guidance
- GAAP earnings included the accrual of the KFTC's approximately $868mm fine announced in late December, which is excluded from our non-GAAP results
- The accrual impacted fiscal first quarter GAAP EPS by $0.49 per share and raised our full-year GAAP estimated tax rate by approximately 280BPS to 22%
- We plan to appeal this decision, but we are still required to pay the fine within 60 days of receiving the written order, which was received earlier this week
  - We returned $1.2B to stockholders in the quarter in the form of dividends and buybacks
- As of the end of the fiscal first quarter, we had approximately $2.5B of our stock repurchase authorization remaining

Guidance

Revenue

- Turning to our guidance for Q2 FY2017, our outlook reflects the seasonally stronger December quarter, 3G/4G device shipments for QTL, and the seasonally lower first calendar quarter MSM shipments for QCT, typical for this time of year
- We are not forecasting any impact to revenues related to the dispute with Apple, as we are continuing to meet their supply needs in good faith and expect Apple will continue to meet its obligations
- We have not recorded any benefit to the P&L associated with non-payment of disputed amounts to date or in our Q2 guidance

Non-GAAP EPS

- We estimate revenues to be in the range of approximately $5.5B to $6.3B and non-GAAP EPS to be in the range of approximately $1.15 to $1.25 per share
- We anticipate fiscal second quarter non-GAAP combined R&D and SG&A expenses will be up approximately 6% to 8%, or $110mm at the midpoint sequentially, reflecting employee-related costs that typically begin with the new CY, increased QTL compliance initiatives, and growing investments in data center and 5G.

QTL

- In QTL, we estimate total reported device sales of $74B to $82B will be reported by our licensees in the March quarter for shipments they made in the December quarter, up approximately 24% sequentially and 11% y-over-y at the midpoint

- Our financial guidance includes an estimate for some catch-up licensing revenue we expect to record in the quarter, including some benefit related to the recently concluded license agreements with Xiaomi and Meizu

QCT

- In QCT, we expect MSM shipments of approximately 165mm to 185mm units, lower sequentially, reflecting typical seasonal trends
- Y-over-y differences also include lower modem sales given second sourcing by a customer
- We expect QCT revenue per MSM to be up modestly on a sequential basis in the second fiscal quarter on stronger product mix

Operating Margin

- We expect QCT's fiscal second quarter operating margin to be approximately 10% to 12%, reflecting significant y-over-y improvement, consistent with the product and cost elements that drove our fiscal first quarter performance but down sequentially on seasonality
- We expect to close the TDK joint venture later in this quarter, but are not including the expected impact in our guidance
  - We will update the go-forward implications of closing the joint venture on our next earnings call

Investment Income

- Turning to our investment income, in anticipation of funding the acquisition of NXP, we will continue liquidating the longer-duration risk assets in our treasury portfolio over the next couple of quarters, which we expect to result in lower yields and total returns more in line with short-duration high credit quality folios. The impact of these changes will primarily be seen in H2 the FY
- We also plan to execute a meaningful portion of our acquisition-related financing in H2 FY2017

Interest Expense

- As a result, we expect the combination of lower net investment income and higher interest expense to impact EPS by approximately $0.15 or approximately $300mm before tax in H2 2017 as compared to the levels we saw in H2 FY2016

Headwind

- Despite recent foreign currency headwinds, we continue to estimate mid-single-digit percentage growth of global 3G/4G handset sales in FY2017
- We are estimating that FX headwinds of approximately 200BPS based on current exchange rates will be partially offset by a better than expected outlook for global 3G/4G handset ASPs on a local currency basis

QUESTION AND ANSWER SECTION

<Q - T. Michael Walkley>: Couple questions here, one on the business just in terms of seasonality of the business into the March quarter. Could you talk about some of the puts and takes with a major customer and Korea's new product timing ramp, seasonality for Apple, and then what you're seeing the Chinese market in terms of your sequential MSM shipments?

And then just a clarification for Derek and Don, as you look at the global dispute with Apple going on, it's my belief that Apple actually pays you through some of their ODMs such as Foxconn. Can you just walk us through that, and maybe any accounting issues should these ODMs decide not to pay on Apple's behalf? Thank you.

<A - Cristiano R. Amon>: Hi, Mike. This is Cristiano. Maybe I'll start addressing Q2 seasonality on the chip business. I think Q2 MSM unit movement is largely seasonal. I think we see seasonality tied to two main effects. One, I think you'll have build on the Chinese customers in anticipation of the Chinese New Year, and I think they basically build and bleed as related to Chinese New Year sales. We also saw units in Q2 are dependent on timing on launching on flagship devices within the quarter, and I think we're going to see some of those clearly towards the MCC announcement. So it's going to be more on flagship devices. It's going to be more of a H2 the year.

And I think in terms of your question on China market position, we'll continue to see strong demand for industry-leading products in China. I think we see good traction at the OEMs, with our MSM roadmap. So it's mostly seasonality that I would experience in Q2.

<A - Derek K. Aberle>: Mike, this is Derek. To answer your question, so you're right, Apple does not have a direct license with Qualcomm today, and so the royalties on Apple products that get paid to Qualcomm are reported and paid by their contract manufacturers. So although we do have a dispute now with Apple and they're challenging some of the offers and some of our licensing terms, the contracts that we have in place with their suppliers remain valid and enforceable. And we would expect that our licensees will continue to comply with the terms of their agreements. And we would also hope and expect that Apple would not interfere with the terms of those agreements. But of course, we can't fully control those actions.

So I guess a little bit, we're going to have to take a wait-and-see approach. We have no indication as we sit here today that our licensees will stop paying royalties. In the past when we have had disputes with companies related to the royalties they owed under an existing valid agreement, generally those companies tended to report and pay royalties even when we're in disputes like an arbitration. You might remember that was the case with LG when we had the recent arbitration with them, also the case with Panasonic when we had a previous arbitration with them. So we'll have to wait and see what happens, but that's the indication we have today.

I guess the final point I'll make is we don't believe or expect that we will see an impact in Q2, our second fiscal quarter, from the dispute, and our guidance reflects that.

<Q - Simona K. Jankowski>: Two questions for Derek. Apple claims that your NDRC rectification plan has never been adopted or endorsed by any agency or court, and they're challenging your royalty rate in China and have now taken it to court there. So can you clarify if your new license structure in China was in fact endorsed or not by the NDRC?

And then the second question is I don't think you addressed Apple's charge that your chipset exclusivity agreement was evidence of abuse of monopoly power. So I would love to hear your position there as well.

<A - Derek K. Aberle>: Hi, Simona. It's Derek. So in China, basically the way that the NDRC investigation was resolved, the NDRC issued an order and Qualcomm submitted what we called a rectification plan. And within the rectification plan, we basically committed to offer a new set of licensing terms for sales for use in China under our Chinese essential patents. And as part of that, the NDRC agreed and this was made public I believe in a press release at the time that Qualcomm's rectification plan and the commitments that we made in that fully addressed the issues that were raised in the NDRC's order. So although I'm not sure I would use the term endorsed, certainly we believe the NDRC agreed that the rectification plan and the licensing terms are very consistent with addressing the concerns in their order.

Of course since then, we've gone out and negotiated and signed over 120 license agreements with terms that are consistent and reflective of the NDRC terms, and that was done under the supervision of the NDRC. So we feel very confident that those terms are fair and reasonable, and we think it's a difficult position for Apple to claim that those terms are not FRAND [Fair, Reasonable, And Non-Discriminatory]. By the way, we have offered those same terms to Apple as we did with all of our other licensees, and they have refused to accept them.

<A - Donald J. Rosenberg>: Simona, this is Don. With regard to your question about so-called exclusivity deal, first of all, I think you called this monopoly power, we had monopoly power. We don't believe we have monopoly power in the chip market or any other market, nor do we have an exclusivity arrangement. We have never prevented Apple or anybody else from buying from competitive chipmakers. And in the Apple case, it's pretty clear since, as you know, they've been buying from Intel fairly recently. So it's a mischaracterization to call it an exclusive dealing arrangement. We have been defending that accusation in Europe for about, I don't know, four years now, and it's not new, although now it's out in the open that Apple is the one who has challenged us on this, and we will continue to defend it both in Europe and in this case. But we are quite confident that it doesn't fit the definition of an exclusivity deal here and it doesn't violate any competition laws.

<Q - James E. Faucette>: Just one clarifying question. I think, Derek, you mentioned a couple times that Apple's ODMs continue to comply. So should we understand that according – I mean per your understanding of the contracts that they're paying the contracted amounts in full?

And then I guess for Derek and Don, how should we think about timeframes for both the KFTC and U.S. FTC cases in terms of how long to go through the process of appeal or the case itself here in the U.S.? And then, Don, you also just mentioned Europe. Where are we on that investigation, and any sense of timing on when you may see further progress or the next steps there? Thank you very much.

<A - Derek K. Aberle>: James, this is Derek. So on the ODM contracts, I think the point to keep in mind is that, again, Apple is not a direct licensee, and we have valid and enforceable contracts in place with their contract manufacturers who are our licensees and have been paying royalties to us under those agreements. Again, we would expect and hope that our licensees will continue to comply with their agreements and that Apple will not interfere with those contractual relationships that we have in place. And we have no indication as we sit here today that the ODMs will stop paying or that Apple will interfere. But we obviously can't control their actions down the road, so we'll have to see how that develops.

As to our guidance in Q2, we believe at this point that will not be an impact in terms of the revenue for QTL in Q2, which would be sales through the December quarter.

<A - Donald J. Rosenberg>: James, this is Don. So with respect to I guess three questions, one on timing of KFTC, timing of FTC, and then DG Comp status. The KFTC, as Derek indicated earlier, has now issued its order in that case, which means that the order is now effective as opposed to the press release that was issued less than a month ago, and we will now be able to seek an appeal at the Seoul High Court. And once we've started the appeal process, we will immediately seek a stay of the remedial relief that was ordered by the KFTC. And we are obviously going to make pretty strong arguments with respect to their conclusions and hope that that will lead to a stay. And then the appeal process can take quite some time in the Seoul High Court, and then if necessary subsequent courts.

The FTC case, which was filed in District Court in the Northern District of California, as you know, we've said very clearly we think that case was lacking in any real coherent theory of competitive harm. And all one needs to do is read the dissenting statement of Commissioner Ohlhausen to get a good sense of how we object to that and how she did, and I commend it to you if you haven't read it.

We have two paths to follow. Obviously, once a new Federal Trade Commission is assembled, we will probably go back to the full commission, or at least when there are more than two commissioners in place and seek a reevaluation of that late decision to file, and hopefully we might be able to get that withdrawn. If not, we will proceed with, as usual, defenses in the Northern District, and that will take some time obviously.

With respect to DG Comp, we have two statements of objections, as you know, that we have been defending there, and I have no new news as to timing there. We are waiting at this point for the next step from DG Comp.

<Q - Timothy Patrick Long>: Two quick ones, if I could – or maybe not quick. George, you mentioned – I think your language was there was no benefit to P&L impact from non-paid amounts. Are you referring to what Apple called the rebates or the payments in their complaint? But either way, if you can, just talk about changes in contracts. It sounds like nothing has hit the P&L yet, but where was that impacting? Was that a COGS item in QCT? Was it somehow on the QTL line? It would be helpful for us to understand where that is. And if there's more that's not going out, at what point would that become a benefit to the Qualcomm model?

And then, Derek, you talked a lot about this being about just raising a commercial agreement. I would just love your perspective on the other major patent holders, the Nokias and Ericssons that I think also license at the device level, but their rates wind up – you're 5 or 10 times higher than them. So could you just talk a little bit about maybe your difference in materiality of your patent pool relative to the other players that might result in higher rates than the others which consider something lower to be FRAND. Thank you.

<A - George S. Davis>: Hey, Tim. This is George. So yes, there has been no P&L benefit from the payments to date. They've been held on the balance sheet as current liabilities. As you know, the agreements are now subject to litigation, and so there's a limit to how much we can describe where they might – how things might be resolved in the future, but the amounts will remain on our balance sheet until the dispute is resolved. And then we'll account for them in whatever way that the resolution is reached.

<A - Derek K. Aberle>: Tim, this is Derek. So I'll try and keep this as concise as I can. If you think about the contributions that Qualcomm has made to the technology first and all the way back to 2G, but then moving onto 3G and 4G and now on to 5G, all the way along the path, we really have been, from our perspective, the leading contributor to the most valuable portions of the technology that are in those standards. And I think that has borne out through the commercial agreements that we've been able to negotiate through arm's-length and fair negotiations over the years with 250-plus licensees.

As Steve mentioned in his remarks, those aren't agreements that are just 20 years old. Many of those have been renegotiated several times with the largest players over the year and continually reaffirm the value of our portfolio. So we believe our contributions, which tend to be more focused on the device side and then the overall system as well, are just frankly more valuable than some of the other contributions that we see across the industry.

And the second piece is you have to look at the circumstances under which the other companies negotiated their licenses. Obviously, when Nokia negotiated a number of their licenses, they had a significant device business and they bargained for cross-licenses from other patent holders, which would have been an offset and helped establish the value of their portfolio. The same is true with Ericsson. So again, those companies both have made significant contributions. I'm not doing anything to suggest otherwise, but we believe that our contributions have been different in kind. And again, the market has valued those contributions through the agreements that we have negotiated over the years.

<A - Donald J. Rosenberg>: Tim, this is Don. I just want to add one or two points to Derek's. Primarily as he said, we have made enormous contributions. But the point that Derek was making needs to be hammered home because people get confused. He was talking about cross-licenses from the likes of Samsung and Nokia. As you know, we're not in the device business. So when we're negotiating, we're not seeking cross-licenses to be able to sell devices as they are, and so that's a whole different dynamic in the negotiation, and people often get confused about that.

And the other thing is, it would be interesting for people to take a look at because there's a lot in the record of this, of all the lawsuits that Apple has brought against its competitors and look at what they've sought in damages for just a couple of patents, or less than a handful of patents. So that's an interesting comparison to what they're claiming in terms of the portfolio that we have.

<Q - Rod B. Hall>: I guess I've got a bunch. I'll try to boil it down to just a couple. One is, can you clarify whether Apple's deal or Foxconn's deal was set to expire at the end of 2016? We understand it probably was. But could you just clarify whether that is the case and in fact, this is part of a normal deal expiration and then the negotiations then ensue after that. That's my first question.

Second question is on materiality of this if they were to stop paying. We've done our own calculations with EPS impacts up around 30%. Others have gotten around 25%. I wonder. Could you guys just say whether those calculations are in the ballpark? And if not, give us any kind of idea what sort of EPS impact we might expect if they were to stop payment.

And then I guess my last question for you is whether you've had any direct discussion with Foxconn. And are the comments you're making that they should continue to pay strictly based on legal agreements, or are they based also on some discussions that you've had with them and that have been sued after these suits were filed? Thank you.

<A - Derek K. Aberle>: Rod, this is Derek. Maybe I will take your first and last question, and then maybe George can jump in on the other one. So we don't have – the agreements that are the subject of the dispute with Apple are with Apple. We don't have agreements with Foxconn, and I think it's fair to assume that those agreements basically expired at the end of 2016.

As to Foxconn, again, we don't typically get into discussions we have with our licensees. What I can tell you is we have no indication, and we do have frequent interactions with our licensees, we have no indication at this point that Foxconn or any of our other licensees will not comply with the terms of their agreement. So that's probably the best we can tell you at this point.

<A - George S. Davis>: Rod, on the materiality, clearly Apple and Samsung are two very large customers, Apple being one of them. We said the two largest is about 40% of revenue, but that includes both chip and licensing for both. The way we think about it is, one, we've seen customers actually continue to pay even during disputes in many cases, and also our ongoing relevance to customers across their business generally provides additional coverage there. But part of why we have a strong balance sheet is so that when events like this happen, we're able to not only sustain ourselves and the investments that are required, but we're able to fund acquisitions and other key initiatives of the company. So we feel we're in a very strong position to continue to execute going forward and under almost any circumstance.

<Q - Timothy Arcuri>: I guess my question, Derek, is really what does Apple want? Because if you look at the effective rate that they're paying, they pay basically on COGS and the contract manufacturer pays you. If you do some math, they're in the low to mid-200BPS as a percentage of COGS, which doesn't seem to be that much different than what the 4G rate that you signed in China is. So what do they want other than just getting a better deal? I guess that's my first question.

<A - Derek K. Aberle>: Tim, this is Derek. Really, if you peel apart all of the arguments that Apple is making, as we said, we believe firmly that they're all without merit. In the end of the day, they essentially want to pay less for the technology that they're using. And it's pretty simple and that's really the motivation. And again, they wrap a lot of stuff around that, which really we think over time we will be able to clearly show is false. But in the end of the day, they want to get to a lower payment. And we think that's not appropriate given the value that we've established. We think they should pay a fair value, the fair value that we have established and that our other licensees are paying, and that's unfortunately why we're in the dispute.

<Q - Timothy Arcuri>: Okay. And then I guess just as a quick follow-up, Derek, what is the way think about the sustained royalty rate? Does this change how we should think about it, this and particularly what's happening with the KFTC as well? Does that change the 290 basis point longer-term rate that we should think about? Thanks.

<A - Derek K. Aberle>: I think from our perspective, again, as Don mentioned, we are going to appeal and seek a stay of the decision in Korea. And in the end of the day, if that decision even were to come into effect, it does not invalidate the contracts that we have. It just sets forward a process for having us enter into renegotiations with some number of companies, and then if you can't resolve that, ultimately enter into some kind of dispute resolution. But we believe firmly that the contracts that we have in place are compliant with FRAND and consistent with our obligations. So we would expect even if we had to go through that process that we would end up in the same place.

So again, as we look at all these things, also the FTC, we believe that we will be able to defend against that claim hopefully more quickly rather than over a longer period of time, and we ultimately believe we will prevail in defeating the arguments that are being brought by Apple. So really none of this affects our long-term view for the growth of the business or the 2.9-ish percent effective rate that we've talked about as a normalized rate over time.

<Q - Stacy Aaron Rasgon>: I have one on Apple and then two quick operational ones. Just on Apple, the structure of your business, obviously device-level pricing, you've laid out a good case for why it's done this way. Has this model ever actually gone to an actual court in front of a judge and jury? And if so, when and what happened in that case? And if it hasn't, can you please tell us if it's never actually gone into court?

In terms of operationally, just briefly, can you give us a feeling for how much of the TRDS guidance next quarter is catch-up? And can you give us a feeling for what's going on with your inventories? Why are they so high? Why did they go up so much into a quarter when chipsets are falling a lot?

<A - Derek K. Aberle>: So, Stacy, let me take your first question. Listen, as we noted in some of the comments, if you look at Apple's complaint, one of the things that they argue is that royalties should be based on just the baseband chip within the phone or what they refer to as a small and salable unit. There really is no legal precedent to suggest that when you're licensing a portfolio of patents such as a large portfolio standard essential patents that that legal doctrine has any application. And there are numerous examples of reasonable royalties being set in court cases as a percentage of the end product.

So this is a well understood, I think a well laid-out concept, and it's consistent with the way that not only Qualcomm has licensed in our own industry for decades, but also virtually every other patent holder when they're seeking to collect royalties on their intellectual property. And I think as Don mentioned, even when non-standard essential patents are asserted, royalties have been sought on a per-unit basis far in excess of what Qualcomm charges for a much larger technology contribution in a license. On the question on TRDS, I think you probably have to – the impact of the – was it on Q2?

<A - George S. Davis>: If you think about, in terms of the impact of catch-up, the overwhelming growth is coming from these seasonal movements. And less than a third of the EPS impact is related to catch-up, which is pure revenue and pure profit.

<A - Cristiano R. Amon>: I can address the inventory question. So, Stacy, I think inventory – maybe three topics for you to think about on the chip side. I think one is, as we said, the Chinese New Year. So I think given how we feel good about our position in China, it's just providing increased assurance of supply and meeting customer demand as some of those products launch.

The other thing to think about it is, we had early in the year, as normal with any new process node, we had conservative planning on 10-nanometer ramp. We just had a little bit more ports off the predecessor in case some of those things shift into the quarter. And the last one, I think you probably know this, cancellation of orders from a customer of one of our flagship products last year that got canceled. And those things will flow through normal inventory levels throughout the year.

<Q - Kulbinder S. Garcha>: I have a couple of questions. On the Apple situation, maybe for Derek, Apple put in the lawsuit that they would be withholding payments to their contract OEMs. Now I know your licensees are saying that they will continue to pay you, whether it's Hon Hai or whoever, but there must be a risk that that gets withheld from you at some point. Are you just saying that you don't see it right now? That's my first question.

And my second question, linked to Apple, is that there were various points in their lawsuit that seemed to imply that they didn't have visibility over which intellectual properties they had indirectly licensed. And so my question is, are there vast parts of your portfolio which they haven't licensed and what are you doing about maybe pursuing them, or is that something that you're considering right now?

And then my operational question just on China is what level of compliance are we at now of the market with the deals you've recently signed? What run rate are we at? Thanks.

<A - Derek K. Aberle>: All right, Kulbinder. So let me take each one of those. On the first question, basically what Apple said in its complaint was that it would withhold payment to its contract manufacturers of an amount equal to what it claims that we owe them, but it didn't go beyond that. In other words, it didn't say that it was going to withhold payment of all royalties going forward. It just talked about the amount that was in dispute, and I think George covered off already how we've already dealt with that in our P&Ls.

But again, on a going-forward basis, these are valid enforceable contracts with our ODMs. There's no question there. And we would expect to get paid on a going-forward basis, and we would also expect that Apple wouldn't interfere with those contracts. But we have no indication as we sit here that either party will do either of those things, meaning withhold payment or interfere, but again, we're going to have to take somewhat of a wait-and-see approach. This is a fluid situation. The complaint just came late last week, and we're continuing to monitor the situation. And we'll be updating you all as things progress.

We have given Apple more than full visibility into the scope of our technology and the scope of our patent portfolio, and they have a tremendous amount of information from us in terms of what we expect them to pay for in terms of our technology position. As I said before, the contracts that we have today are with their contract manufacturers. Those agreements do not include licenses to all of our portfolio, but we've been discussing a direct license with Apple as well, which would obviously include a broader portfolio license. So I'm probably not going to comment today on our legal strategy as to what we may or may not do with the patents that are unlicensed to Apple or our contract manufacturers, but there are some patents in our portfolio that are outside those agreements.

I mentioned in my remarks that with the further progress in China, we're now in a position of collecting on about 80% of the Chinese OEM global device sales. You may remember back in February at the last Analyst Day, we talked about trying to get to about 75% collection with the key deals, and we're now at 80% and hope to over time take that number higher.

Steven M. Mollenkopf

Closing Remarks

We obviously are working through our dispute here

We'll get through it like we have in the past

I appreciate everybody's patience here, but we're going to do the right thing for shareholders

I also want to recognize and thank the employee base for really their strong work in not only repositioning the company but also delivering the results that we showed today