UBS Global Technology Conference

Company Participants

- Colette Kress, EVP and CFO
- Steven Chin, Analyst

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Steven Chin {BIO 16211528 <GO>}

Good morning, everybody. We're going to get started with our next session here this morning. Thank you, all for attending our UBS Tech Conference again this morning.

My name is Steven Chen -- I am one of the research analysts here at UBS. It is my pleasure to welcome NVIDIA to our session this morning. We have got Colette Kress today from NVIDIA. She is NVIDIA's Senior Vice President and Chief Financial Officer. Thanks, Colette, for joining us today.

Colette Kress {BIO 18297352 <GO>}

Thank you, Steven.

Steven Chin {BIO 16211528 <GO>}

So I thought we'd just host a fireside chat this morning, go through a couple of question-and-answer sessions. Then maybe if there is any time, we will see if there is any questions from the audience.

So congrats on being at NVIDIA for a year. Seems like you have put a lot of new programs in place, such as the capital return program, integrating the product architectures, especially with the convergence of the GPU architectures. And diversifying some of your market exposure.

Maybe you can just give us a quick recap to begin with of where the Company stands in terms of maybe some of the changes you have implemented. I see you guys have reported earnings last week. Maybe just a broad picture of where we are at to start with.

Colette Kress {BIO 18297352 <GO>}

Sounds great. So we did -- we reported earnings about a week ago, indicating our Q3 financial results for the fiscal year. And a real strong quarter in terms of we finished with record revenue. At one point, $2.2 billion. And 15% growth year over year.

So far, year to date, in fiscal year 2015, we have grown 15% year over year over this period of time. And within the Q3, again, really focusing on profitability of growth.

Our overall diluted EPS for the Q3 year over year grew more than 55%. So we are really pleased with the overall results. We are kind of breaking that down in terms of what we saw in terms of the businesses.

Our real focus is along three key platforms. And where we saw growth was across all three of these three platforms. The first one being our PC business, which is a particular part of our core. Our core as it relates to our gaming industry as well as our design. So two areas in terms of GeForce and Quadro.

Very strong growth in terms of our gaming segment year over year within the quarter, growing about 36%. And this is largely due to our release of our Maxwell architecture that we released within the quarter. And the adoption of that quite nicely in terms of the overall gaming as a tremendous improvement for the overall gaming universe.

Our second platform, being datacenter and cloud, also did extremely well. We again hit another record quarter in our overall Tesla business, which is for high performance computing, parallel computing. And some of the aspects of new machine learning that we are seeing.

Our overall mobile business also a very strong quarter, growing year over year, associated with all of our different SoCs. SoCs in a lot of our different mobile platforms, from tablets to phones as well as our most mobile type of platform, the automobile, which saw about a doubling year-over-year growth in terms of our automobile.

So we are really pleased with that transformation of not a chip type of approach. But really a platform approach that we have done across here. And I think that takes a lot of work over the last couple of years, really working with the end customers who think about gaming.

Or if we think about the datacenter and we think about what we want to provide to the consumer on the mobile, really reaching out and establishing the software around that and what it means for the ecosystem to grow. So we are very pleased.

Steven Chin {BIO 16211528 <GO>}

Okay. Thanks for that introduction. Maybe we could follow up with some of the comments you just mentioned on the platform strategy.

In terms of NVIDIA transforming from a chip company into this platform-type company, could you tell us where you think we are, using the baseball analogy of how far along we are in terms of taking the product through all these portfolio changes in addition to some of the software resources and the diversification of sales into some of these stickier revenue opportunities.

Colette Kress {BIO 18297352 <GO>}

Yes. So definitely a focus of ours. When we thought about the amount of innovation that we have built into the overall GPU and the GPU from its overall visual capabilities as well as all the compute. Really expanding into markets that can really leverage that capability.

We have experienced that from the overall gaming side. And to really kind of talk about that further, gaming is a extremely popular, probably 10% to 12% growth, type of industry each year. But it is not about just providing that overall GPU.

The amount of work that we have built over the years working with gaming developers on the new games that reach the market, which are, again, higher and higher needs in terms of the GPU. We have worked the background in terms of that ecosystem, such that when the user actually puts in their GPU, it works seamlessly with those new games.

It takes into account the features of the game, the configurations that would make that experience the most valuable to the gamer. Gamers appreciate that. It is a very well-known brand recognized GeForce around the world.

That if you want to do the great PC gaming, GeForce is there because of that background work that we have done. Not in terms of building a chip. But all of the software that goes with the overall boards as they use it for their overall gaming experience.

We can take that same concept as we move into design and we think about all the different uses that people are using the GPU to design everything that we have in the world. In terms of almost all of the cars, all of the planes, all of the buildings are usually built using GPUs for that rendering and that aspect, because of the work that we have done with the software developers, the applications, to make sure that that works seamlessly from generation to generation, that they can continue to use that design.

We move, then, into the datacenter. And there is an extension as well of working with the key applications in high performance computing, the parallelism as well as our ability to program the overall GPU with our CUDA development platform that has

allowed us that stickiness and being able to solve customers' problems in the datacenter.

We move to our mobile area and really taking what we have learned from the gaming experience on the desktop to a more mobile experience as well has really, really benefited us as well in some of the high end tablets for use in mobile gaming has been just tremendous.

And lastly, our automotive. That is eight years in the making of working across that industry, working with manufacturers on building the next generation of cars. We are talking about a significant amount of algorithm software and the technology for both safety and security as it goes into the car.

So we are really pleased with how that long-term relationship has really benefited to us right now.

Steven Chin {BIO 16211528 <GO>}

Okay. Thanks for that overview on the platform strategy. Maybe to drill down a little bit more into the individual segments here, just starting maybe with the PC GPU. You spoke a little bit about how the platform approach is changing the way that you do business in this PC market.

Maybe you could expand a little bit on the implications to pricing and also margins for the GeForce products, given that some of these PC OEMs are less than a quarter of your GPU business. Are you depending more on the retail channel as well as prior years?

Colette Kress {BIO 18297352 <GO>}

Yes. So what Steven is referring to is our overall GPUs for desktops and notebooks. Again, being a significant part of our core, we segment that between what we believe people are using for a use case of gaming and what we believe is just for a general overall PC.

The volumes and the price points that we see in terms of a gaming aspect has continued to be a very important part for us in terms of our overall revenue growth. That is an area where not only is the PC gaming community extremely vibrant. But they are using more advanced GPUs for a better experience. It is not all about gaming personally -- it is actually now about watching others game in that arena. And so that is really, really a interesting sport around the world in terms of what that has expanded to.

In those areas, we hold a extremely strong market share in the gaming in Asia Pac, China, many of the parts of Europe, as well as in the US. And what we see is what they may have started in terms of a GPU and gaming at a price point earlier, several years ago, they continue to buy more and more advanced GPUs for better ASPs over

that period of time. So we are seeing a mix really to that high end as one of the best overall platforms to do their gaming in terms of on the PC.

Now when we think about the overall PC OEM, a little bit of a different dynamic. Again, our approach really from a platform strategy is not to attach to every single PC around the world, because as we know. So many of the different PCs are used for so many different types of opportunities. But we remain tremendously competitive in the overall attach rate in a general purpose PC or notebook.

When we look at the overall notebook business, this is, again, a lot of movement to buy a more mobile platform, particularly in the gaming world, where you had seen gamers previously stay within their living room. Now they are finding that the efficiencies of our new GPUs really allow them to experience that also on a notebook. And we discussed again in Q3 our overall notebook business for gaming growing almost double, as gaming notebooks are becoming a tremendous popular and an interesting attach rate for us.

Steven Chin {BIO 16211528 <GO>}

Okay. Thanks for sharing that color on the PC GPUs. If we could just follow up on the datacenter GPUs. In terms of GRID, it looks like some of the numbers would suggest the test trials are up over 20 times versus the past two years, if we try to compare some of our notes, that would be about just 1,000 now, perhaps.

Can you discuss some of the revenue conversion rates that you have seen from some of these test trials over the past couple of quarters? And what is the typical qualification that a prospective customer goes through for these datacenter GPUs?

Colette Kress {BIO 18297352 <GO>}

Yes. So let me start back in terms of our overall GRID platform. So a GRID is our virtualized GPU. So different from our one-to-one relationships with our current GPUs on a desktop and notebook or on a server.

What we are talking about is multicurrency, concurrency of users reaching that overall GPU that may be located in the server. So over a streaming environment, over a cloud environment, access to the GPU.

So it is bringing in very unique use cases where that would be viable, both on a VDI opportunity in the enterprise. But also in terms of a consumer streaming gaming, becomes a very important market to think about.

Now the way we approach this was really certification with each of the OEMs for that GRID to take place in those different cloud environments. But more importantly, was working with key partners, such as Citrix as well as VMware, as those are some of the key virtualization providers across the world on both the client aspect as well as the backend server aspect.

So over this period of time that we have had the GRID product available, we are working with each one of those partners to develop the software within their offerings that will allow that GRID opportunity to work seamlessly across the environments. The understanding as well as the adoption of that through the trials, the interest, continues to grow more and more.

But with anything in the enterprise, the time it takes to start with one or two trials, understand that, move out to a project -- to move out to broad availability does take time. And in each case, I wish I had a specific time of how long that takes. But we are solving some pretty important needs and, in some aspects, we see immediate rollout.

In some aspects, it is a working with VMware, working with Citrix on the availability of their software to where they can take part on that in a bigger, bigger type of deployment.

So within this year, we are expecting tens of millions of dollars from GRID, which is a great start for really being an only market for about a year. But it has a tremendously strong outlook in terms of a growth provider, as that cloud enables quite a bit of a unique ability for global teams to work and share visually important renderings across the world in that scenario.

Steven Chin {BIO 16211528 <GO>}

Great. Thanks for sharing your thoughts on GRID. Maybe just staying in the datacenter GPUs, a question on Tesla, especially in the high-performance compute application. That's also done very well for NVIDIA the past year.

So the question is, is this continued demand that you are seeing for Tesla, would you characterize it from repeat buying or is it also new customers, perhaps new applications? What are your thoughts on Tesla?

Colette Kress {BIO 18297352 <GO>}

Yes. So Tesla has definitely been a great product over the last five years, focused in high-performance computing environments for parallel processing. It has really been a key understanding with the overall CUDA development platform to really take a lot of that workload off of the CPU to the GPU in those environments. And that continues to be a great growth opportunity.

But what is interesting is the expansion that has been happening over the last year as the focus on machine learning, artificial intelligence. And really training the overall applications and servers in terms of information. So Internet service provider or cloud service providers around the world really focused on the amount of data, both voice and video, traveling through their networks and wanting to really get a good understanding on how to tag all of that different information.

As you see with many service providers the use of voice recognition. And voice recognition across many different dialects and many different languages is very important.

The use of the GPU to teach through those applications has been a very, very high area of interest. It also moves in terms of video and picture tagging as well, meaning can I recognize a dog -- a Labrador dog -- across a cartoon, a colored picture, or some type of other artistic view of that.

So it is a very interesting field, tremendous amount of research and high-end education as well as with these Internet service providers that have driven tremendous project growth for us in our Tesla business, allowing us to reach some of the record levels that we have.

We are just in entering this initial, I think, phase of what machine learning and the expansion of where it will be. But again, there is tremendous understanding in research in terms of their capabilities.

Steven Chin {BIO 16211528 <GO>}

Okay. Thanks for sharing those thoughts on Tesla. Maybe to transition into the mobile GPUs on the tablet front with SHIELD. The SHIELD handheld and also the SHIELD products. I know Jen-Hsun likes to highlight some of the success with SHIELD.

Given that is sold under NVIDIA's own brand name, maybe you could help us characterize the demand for those products? What kind of your thinking is there with SHIELD.

Colette Kress {BIO 18297352 <GO>}

Yes. So our SHIELD family of products, including our SHIELD Tablet, is really a set of products using our underlying mobile GPUs for the overall gaming industry. What we have learned is our tremendous brand recognition and following in the overall gaming market and wanting to move that to a mobile type of piece, there was no better opportunity other than an overall tablet geared on our underlying technology to take advantage of that.

So the reviews, the response from these tablets has been tremendous, in terms of some of the best performing tablets out there in the market to take advantage of that gaming experience. It is really an expansion -- a necessary expansion, as we know, when you enter into a sport on a gaming, it is something that they want to do everywhere.

You see more and more people doing this from a mobile aspect. So taking that same experience that they are doing on the desktop in their living room, they do want to move to a more mobile experience. As we have seen the expansion of Android

gaming and high-end Android gaming as well, we have really worked on building that portfolio of Android games that go along with that experience to really benefit from the overall tablet.

So we are in the initial stages. Again, this is a new area for us to move into from some of the places that we have been in the past. We are extremely pleased with the overall demand. We are currently supply-constrained because demand is stronger than our overall supply. And we will continue with the overall global launch of these products set for the upcoming holiday season. And we'll talk about it more when we finish Q4.

Steven Chin {BIO 16211528 <GO>}

Okay. Great. Thanks for those overviews on the products at NVIDIA. Sounds like you have a lot of exciting opportunities going forward.

Maybe we could just transition to talking about some of the NVIDIA financials. Perhaps we could start on the gross margin. You have seen some pretty good benefits in gross margins, perhaps a favorable sales mix towards datacenter and cloud. Is sales mix the right way of thinking of the driver to gross margin here in the near term? Or are there other Company initiatives that you have going underway that could also drive margins?

Colette Kress {BIO 18297352 <GO>}

Sure. So I think mix is a good important part. It is not just our enterprise datacenter and design products that overall drive our higher growth in margins but it is a key point on that. As those have been growing and because they take place in so many mission-critical types of applications, we are to benefit from a very solid gross margin that is better than the Company average for those.

Additionally, as people have been upgrading in the overall gaming side of our overall ASPs, we have also benefited from very, very stable and sometimes growing gross margins in that arena.

The other aspect that we think about is on our Tegra side. The more software -- the different type of form factors -- we are talking about different ASPs, we are talking about different gross margins kind of going forward. But probably more of a volume play than an overall gross margin % on those pieces. So yes, the topline can be affected, particularly by the overall mix, which can help our gross margin.

But to focus really on the cost of the processing, we had discussed our unified architecture about a year ago in terms of a single architecture that expands from the desktop and the notebook all the way to our overall mobile platform. That helps us both from the engineering expense. But it also does help us in terms of the costing that it takes in order to build across our overall platform. So focusing on the cost element as well as our overall ASPs allows us the long-term focus on gross margin as healthy as we can possibly get it.

Steven Chin {BIO 16211528 <GO>}

Okay. Thanks for sharing your thoughts on margins. Maybe just a follow-up on the investments in research and development. You spent some time speaking about the investments in some of these platform strategies.

It sounds like maybe there is some investments needed in some of the software features and perhaps before revenue starts. So maybe you could talk about how this approach has worked so far with your R&D spending and perhaps what some of the key investment areas are for the Company that we should think about.

Colette Kress {BIO 18297352 <GO>}

Yes. In fiscal year 2013 and fiscal year 2014, the expansion that we were needing to do, as it focused on the datacenter and focused on many aspects of the enterprise in mobile, took that time for building out that engineering to really concentrate on the SoC and then also concentrate on the enterprise.

There is a tremendous amount of software development in almost all of our products. Not well known is we actually have more software developers than we have hardware developers at the Company, just based on the overall platform approach that we have.

But moving into fiscal year 2015, it was time to really see that come through on the overall revenue side and look for an overall efficient base in our overall development platform to be assured that we can maintain about flat overall operating expenses in fiscal year 2015 while overall seeing the benefits on the topline. And we are really pleased with that. As you can see with the year-to-date revenue growth of 15% and profitability exceeding 40% or more in any one quarter year over year, it is really helped us out on the overall profitability.

We continue to focus on areas of both efficiency. But also being assured that we are continuing to invest in key platforms that have strong growth potential going forward. And so it is really a balance of the efficiency against the areas of investment, expanding into those datacenter, expanding into mobile, new partners, new sales channels. All different things that we have got to absorb within our cost structure.

So we will continue to focus on it. And it is a good amount of work on that. But we are very pleased with the results we've seen so far.

Steven Chin {BIO 16211528 <GO>}

Okay. Thanks for sharing that on the R&D investments. Maybe just a follow-up on some of that sales growth that you are seeing so far of the 15% year to date. Can you maybe share with us how the intellectual property revenues or the licensing business kind of fits into the overall business model and financials going forward?

It sounds like you will have a pretty balanced product solution business and then perhaps the IP licensing business. If you could share some thoughts on that, Colette.

Colette Kress {BIO 18297352 <GO>}

Yes, I can. So about a year and a half ago, we had discussed our overall strategy regarding IP and IP licensing. And the reason why was as the leader in terms of graphic technology, we had a portfolio of about 7,000 issued and to be issued patents. Probably one of the highest levels for the overall size of the Company we are is really based on the overall leadership that we have in terms of the graphics.

It was an opportunity for us to articulate how we see that moving forward, from both the ability for us to license our GPU core and our ability to license overall patents that we may in terms of many of our different customers.

So we have been in works for quite some time. One of the very well-known licensing agreements that we have is with Intel that we signed earlier. They have access and a cross-license to our entire portfolio of overall patents that we own.

As we move forward, post the announcement and discussions, as we have seen in the last two months, we moved forward in terms of litigation against Samsung and Qualcomm on the mobile space. Again, with a lot of IP, sometimes company-to-company discussions do need to move to the next level. And that next level is about determining to the extent of the ownership of the patents and use of the overall patents.

So we did. We did move forward with the litigation. We are working right now on the court hearing date with the ITC, which is planned for the end of June. So we are busy working through. So we should have a good understanding after that in terms of their determination of infringement and overall valuation.

So we think it is an important step in our overall IP strategy. But it is not the only step. We are continuing many conversations with companies in many different configurations on licensing parts of our core, licensing our patent portfolio as we move forward.

Steven Chin {BIO 16211528 <GO>}

Okay. Thanks for sharing that -- thoughts on the intellectual property. Maybe just moving to the balance sheet and some of the capital returns to shareholders. The program has been pretty successful so far, in our view. Maybe you can share your thoughts of how to balance dividends versus share buybacks and how you think we should think about return target as a percentage of free cash flow from NVIDIA.

Colette Kress {BIO 18297352 <GO>}

Got you. So we're in fiscal year 2015. The Company had restarted their capital return program at the end of fiscal year 2013. Fiscal year 2014 and 2015 was an intent to return $1 billion in capital in each of those two years through a combination of both our dividends and our share repurchases.

We were primarily in an aspect of that restarting is to return a lot of the cash that we had received in many of the other profitable years before that. So the $1 billion, for the last two years, when looked at over 3 to five years, has been targeting about 75% of free cash flow over that period of time, which is in line with what you see a lot in terms of in the industry and through our peers.

So we just finished our Q3 and we announced our intent for fiscal year 2016 as well. So our fiscal year 2016 goal is to return $600 million in capital return and again, keeping more in line with what we have seen as a percentage of free cash flow over a longer period of time.

At the end of fiscal 2014, in order to aid that capital return, we executed a convertible debt offering. And the primary reason was for the overall capital return. As we have discussed, a significant amount of our free cash flow or cash flow is earned in international add back. So with the fiscal year 2016 program, we will have returned almost all in terms of the leveraged approach that we had to restore that capital return.

Focusing on the split between dividends and share repurchases. Our overall dividend, when it started, we had targeted near where we wanted to be in terms of peers and make a good solid introduction, as we knew the dividend would be here for the long term.

So our dividend yield has ranged right now about 1.75% to 1.9%, in some aspects. The remainder focuses on share repurchases in really twofold. One, overall share reduction. But also keeping in mind our employee dilutive effect of the RSUs that are awarded. So we wanted to make sure we did more than just that overall dilution effect. We will continue to balance between the two as we go forward. But we have set through what we want to do for fiscal year 2016.

Steven Chin {BIO 16211528 <GO>}

Okay. Great. Thanks for sharing that. Why don't we see if -- we have got a few minutes left. Let's see if there is any questions from the audience.

Questions And Answers

Q - Unidentified Participant

(technical difficulty) Both obviously Tegra but as for the NVIDIA mobile efforts at this stage. (multiple speakers)

A - Colette Kress {BIO 18297352 <GO>}

Okay. So when we think about our mobile strategy, tablets -- remember, there were two parts of tablets. There are specialty tablets in the market. We went to market with overall Jammy and several other, Woohoo, very specific visualization types of tablets. So that is still an important part -- very specific parts of the strategy.

Additionally, our SHIELD tablet, our own tablet, is also a product of that Tegra strategy as we build a tablet specifically for gaming and more of an end-to-end type of aspect.

The other components of our overall Tegra strategy outside of those tablets really focuses on embedded types of robotics, drones. Embedded types of devices, where it is really key in terms of the compute availability in connected overall devices that may be mobile.

Our auto strategy is also a tremendous component. Our auto strategy has really been focused on the high end in terms of the luxury types of brands that we have seen over the last couple of years. Then this last quarter, we announced Honda in Europe will also have Tegra K1 going forward in terms of the automobiles in the European market, in more of the mainstream or midway.

And the other aspect that was extremely important in terms of that agreement was it was based on the overall Android operating system. So we were the selected hardware provider, along with the Android operating system. And this is one of the very first design wins really focused on that for the overall cars.

We have talked about our overall long-term Tegra for automobile as a very strong pipeline, as we have been earning design wins over many, many years. And as the automobile industry works, it is not a design win and the car is on the road in three months. It actually can take a couple years, in some cases three or more years to take that design to overall market. So we have remained extremely in a very good sticky market on the overall automobile.

So I think there are specialty tablets on the Tegra side. There are also very, very key embedded type of opportunities as we move forward and that continues to grow, as also our automobile strategy, which I think is another key aspect of our Tegra.

Q - Unidentified Participant

(inaudible)

A - Colette Kress {BIO 18297352 <GO>}

So our focus on mainstream phones -- we have been pretty open about this, not necessarily our focus of a mainstream, just standard overall phone. We still have key design wins on phones that wanted to differentiate from many of the ones that are out there. And we do have that optionality if they want an integrated modem or not.

Our overall SHIELD tablet product, we have two versions. One that is Wi-Fi and one that is LTE. That LTE version uses our overall modem internally as well. So tablets still can have that opportunity going forward. We provide that option with the best AP that we can in terms of (inaudible).

Q - Unidentified Participant

Let's go back to the supply constraint you mentioned earlier. Sorry if I missed that, if you discussed that on your call. But if you could run me through what -- did you just underestimate the level of demand and then how quickly can you close that gap, please? Thank you.

A - Colette Kress {BIO 18297352 <GO>}

I think when you go to market, I think there is a very interesting time in terms of feeling out that market. We knew it was a very, very great product from that aspect and now we are talking about where that supply needs to sit around the world and how do we get there.

We will solve that. We have definitely opened up the channels in order to do that across. And we actually think it is a true positive in terms of seeing the demand for the overall product. So we will wait and see in terms of this holiday. But the supply is coming associated with that and we are just really pleased with the demand.

Q - Unidentified Participant

Thanks. Just back on the licensing deal with Intel. I just wondered whether you could talk whether that's GPU core or the -- that they are using or intending to use and whether it is the wider patent portfolio?

A - Colette Kress {BIO 18297352 <GO>}

I'm sorry -- I didn't hear the piece of --

Q - Unidentified Participant

For IP licensing, I think you talked about the Intel deal that you have got. I just wanted to -- what their intention are what your joint intention is in terms of product use. Is it for the GPU core for mobile devices, for example, or is it the wider patent portfolio of the 7,000 that you talked about?

A - Colette Kress {BIO 18297352 <GO>}

Okay. So our Intel licensing agreement is the licensing agreement that we have in place right now that we began in 2011. It is -- it runs through to the First Quarter of our fiscal year 2018 or calendar 2017, in that manner.

At that time, it is a question in terms of will it re-sign, will it re-sign differently, will it not re-sign. But at the same time, we have many different other types of agreements of those interested in the overall GPU core, those interested in certain aspects of our patent as well.

So when we have more of a discussion of when those evolve, we will kind of come forward. But there is many different options in terms of that. But Intel is a part of what we have right now as a stream and we will continue to expand that as we go forward.

Q - Unidentified Participant

(inaudible)

A - Colette Kress {BIO 18297352 <GO>}

So when -- we will discuss our overall product roadmap when it is usually here and available. But of course, we are going to move in that direction on that side. So our current products are still at 28. But you can expect us, just as others, that we'll move in terms of that where it's necessary.

A - Steven Chin {BIO 16211528 <GO>}

Okay. I think we are out of time, Colette. But thank you very much for joining us and sharing with us your thoughts on NVIDIA.

A - Colette Kress {BIO 18297352 <GO>}

All right. Thank you.

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