

# Microsoft to acquire Nokia's Devices & Services business - Corporate Conference Call

## Company Participants

- Amy Hood, CFO
- Brad Smith, EVP and General Counsel
- Chris Suh, General Manager IR
- Stephen Elop, EVP, Devices and Services
- Steve Ballmer, CEO
- Terry Myerson, EVP, Operating Systems

## Other Participants

- Brent Thill, Analyst, UBS
- Keith Weiss, Analyst, Morgan Stanley
- Mark Moerdler, Analyst, Sanford C. Bernstein & Company, Inc.
- Rick Sherlund, Analyst, Nomura Asset Management
- Rolfe Winkler, Analyst, Wall Street Journal
- Walter Pritchard, Analyst, Citigroup

## Presentation

### Operator

Welcome to the Microsoft conference call. All lines have been placed on a listen-only mode until the question-and-answer session.

(Operator Instructions)

Today's call is being recorded. If anyone has any objections you may disconnect at this time. I would now like to turn today's call over to Mr. Chris Suh, General Manager, Investor Relations. Chris, you may begin.

### Chris Suh {BIO 17955231 <GO>}

Thank you, operator. Good morning. And thank you for joining. With me today are Steve Ballmer, Chief Executive Officer; Stephen Elop, Executive Vice President, Devices and Services of Nokia; Brad Smith, Executive Vice President and General Counsel; Terry Myerson, Executive Vice President, Operating Systems; and Amy Hood, Executive Vice President and Chief Financial Officer. On our website, [Microsoft.com/investor](http://Microsoft.com/investor) is a slide deck which is intended to follow today's

presentation. As a reminder today's call is being webcast live and recorded. If you ask a question it will be included in our live transmission, in the transcript and any future use of the recording.

You can replay the call and view the transcript at the Microsoft investor relations website. During this call we will be making forward-looking statements, which are predictions projections or other statements about future events based on current expectations and assumptions that are subject to risks and uncertainties. The potential risks and uncertainties include among others, that the expected financial and other benefits from the Nokia transaction may not be realized, including because of factors discussed in yesterday's press release. Actual results could materially differ because of these factors, comments made during this conference call. And the risk factors section of our form 10-K, form 10-Q and other reports and filings with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statement. With that, I will now turn the call over to Steve.

**Steve Ballmer** {BIO 1390481 <GO>}

Thanks Chris. And thanks, everybody, for joining us on this call today. I say hello from Salo, Finland which is one of the heart and soul development facilities for the Nokia Lumia Windows phone. I am excited to have a chance to talk to you about the very bold and exciting deal, transaction that we announced today. On slide four I just want to make sure everybody has the key elements of the deal in mind. I know it's all in the press materials but let's make sure everybody's clear.

Number 1, Microsoft is acquiring Nokia's Phone business both its so-called Mobile Phone business as well as its Smart Device business. Number 2, along with the acquisition of Nokia's phone business, we are also being assigned rights to Nokia's license, IT license with Qualcomm and other key IP licenses. Number 3, we are licensing, not buying, we are licensing Nokia's patents to be able to use them not only with our Windows phone and other phone product lines but across the Microsoft product set. Number 4, we are licensing the ability to use Nokia's HERE mapping geospatial location. We'll use those words interchangeably today, service to use that and modify it broadly in our products.

Nokia is a Company that will continue under the Nokia name. It retains the NSN business which is a network infrastructure business, its location and mapping business HERE, its CTO office and the patent licensing business that goes along with the advanced technology work they're doing. With this announcement, we also cement the original partnership that we put in place two and a half years ago to focus together on Nokia phones that are Windows phones. There was a date in 2014, we call it the recommitment date at which we would each add some options on how to move forward. It's quite complicated. But we have been talking for a while about where we wanted to go. We think we have made excellent, excellent progress with the partnership and yet we also know we have a long way go and felt in balance that together this is the best approach for both companies' shareholders.

On slide 5, I show you a sampling of some of the beautiful Nokia phones. Nokia ships well over 200 million phones a year. The vast majority of those are mobile or feature phones that get sold for prices as low as say \$25. And are often the first connection with technology that people in many places in the world have, with any kind of communications or information technology device. We look at that as an excellent feeder system into the smartphone world and a way to touch people with our services even on much lower-end devices in many parts of the world. And so we're pleased to be acquiring the full capability of Nokia in phones, from mobile phones to smart devices, from engineering to marketing, manufacturing, supply chain management. And the like. Nokia's a phenomenal Company that we really had a chance to work with and get to know over the last two and a half years. We knew the Company earlier. But the working partnership is phenomenal.

On slide 6, I just want to highlight the four key rationales for the deal. We're going to walk through each one of these. Number 1 and most importantly, we are trying to accelerate our phone market share. As good as the work is that we have done together. And Terry Myerson will have the chance to talk about it, we know we need to accelerate. We're not confused about that. We see opportunities to do so and Terry will discuss that. Number 2, we want to strengthen the overall opportunity for Microsoft from a Devices and Services perspective and that opportunity for our partners as well. I will speak about that later. We're going to talk about why this is a smart acquisition from a financial and assets perspective. Amy Hood and Brad Smith will do that. And last but not least, we'll talk about our execution plan and Stephen Elop from Nokia will have a chance to join Brad and I in that part of the discussion.

So with that, I'll turn things over to Terry Myerson. Terry has run our Windows Phone business. He now runs all our operating systems work. He has been on the front edge of the partnership with Nokia and in championing inside this fast forward. And I'm going to let Terry talk about our plans to accelerate phone share.

### **Terry Myerson** {BIO 17496274 <GO>}

Thanks, Steve. Hello, everyone. This is the single most exciting deal in my 17 years at Microsoft, unlocking our potential to win in mobile devices. We can go to slide 8. This all started in fall 2010 when the Nokia and Microsoft teams began talking about partnership. We asked ourselves with two great brands, Microsoft software and Nokia hardware, what could we create? At Nokia we found great leadership, innovative concepts and incredible engineering capabilities, not to mention a flare for original and world-inspiring hardware design.

In February, 2011 we signed our strategic partnership. Nokia would invest exclusively in Windows Phones and Microsoft would bet on Nokia's HERE mapping technology. We shipped our first phone together nine months later, the Lumia 800. Last Fall we shipped Windows Phone 8, which enabled Nokia to create a full portfolio of Windows Phones that spanned a broad array of price points in over 100 countries. Today we have the best selling Lumia 520 at an entry level price point, the 620, the 720, the 820, the 920 which was voted smartphone of the Year by Engadget's Readers the same year iPhone 5 and Galaxy S3 launched. And now the best camera

phone in the world, the Lumia 1020. In just over two years Nokia has gone from shipping no Windows Phones to shipping 7.4 million last quarter.

As a result of our Windows Phone innovations, combined with Nokia's amazing device portfolio, their capability and distribution and retail promotions, Windows Phone has reached over 10% share in nine markets. And in 34 markets Windows Phones are out-selling Blackberry from Australia to China to Brazil, Italy, Mexico, Russia. And the United States. The Nokia Windows Phone momentum has made Windows Phone the fastest-growing mobile platform with 78% year-over-year growth. Every quarter for the past eight quarters more customers have activated Windows Phones than in the prior quarter. We are building momentum. But we still have low share today. Last decade with Xbox and Exchange, we were in this same position, starting small.

Here we aspire to the same trajectory. We need to make the market for Windows Phone. We have to go to the customer with a clear message that highlights Windows Phones differentiation. The marketing approaches we have used in the past are insufficient. This deal enables us to invest in a single marketing campaign, which allows us to officially communicate the Windows Phone value propositions to consumers with one brand and a united voice, making the market for the entire Windows Phone ecosystem. The thing I am most excited about with this deal is how our innovation will accelerate. Our teams have a proven ability to work together and this deal removes the seams in our collaboration. Nokia's mobile phones division reaches a whole new customer segment for Microsoft, shipping over 53 million phones last quarter. We are excited to partner with this team to bring the next billion people on to the internet.

In the area of imaging, the Lumia 1020 has no equal. We are excited to bring this technology together with our breakthrough connect camera technology to delight our customers. Our phones have evolved into our personal assistants helping us navigate our day. This deal brings us a new HERE data license, which when combined with our Bing information platform, will enable us to create a more immersive experience for our customers. From the Skype and Lync experience, to next generation sensors, to how our devices connect to cloud services, to the interactive entertainment, to device categories not yet on the charts, the Nokia and Microsoft teams share a common vision for innovation at the hardware/software boundary. Together we will now explore this boundary together ultimately creating opportunities for all Windows OEMs. Together, Nokia and Microsoft have the scale to combat Galaxy, the design to combat iPhone and the innovation capability to lead it all.

### **Steve Ballmer** {BIO 1390481 <GO>}

Great. Thanks Terry. I am going to talk a little bit about the totality of Microsoft and how this deal strengthens us as a Company in so many ways. So on slide 13, if you will, I want to harken back to themes we have been striking over the past couple months, actually the past couple of years, of the transformation of Microsoft. The Company I joined 33 years ago was a Company focused in on software for personal computers. Software is a great skill and will always be a core strength of Microsoft.

The PC is an important device, the most productive device on the planet. And will continue to be so.

And yet for us to, not only to grow. But for us to really fulfill the vision of what we can do for our customers, we have evolved our thinking. We need to be a Company that provides a family of devices. In some cases we'll build the devices. In many cases third parties, our OEMs, can build the devices. A family of devices with integrated services that best empower people and businesses for the activities that they value the most. The core deliverable for us has been software. And yet the core way in which people will consume that is through hardware experiences as well as cloud services, which is a fundamental transformation for our Company, which is very, very important.

We started the cloud transformation five or six years ago. We have made great progress. We certainly have been working hard on devices. And yet the Nokia acquisition, the deal that we are talking about today, is transformational in terms of giving us the capability to do physical devices in addition to the work we do with our OEM partners on virtual devices for us, that is on Windows PCs. I do think. And we want to touch on why we believe that greater smartphone success is good for Microsoft and our shareholders as well as our partners. I do want to talk about geospatial services and the work we are doing with the Nokia HERE division. Because when you think about the high-value services of the future, these mapping and location services are essential. And we think we have made a smart win-win deal in that area.

If you go to slide 14, the first thing I want to talk a little bit about is essentially, why phones? There are many theories of Microsoft and where we should go, that I get a chance to read and hear from investors and from journalists. In a simple way I would say much as apps help operating systems and operating systems help apps, devices help services and services help devices. Being successful with end-users, I would use the word consumer but it implies people don't have a work life and a personal life, a professional and productive life and a fun life. But being successful with users is absolutely just vital to succeed both at work and at home. Where people talk about the consumerization of IT, that's a phenomenon that we grew up with. The PC represented the first consumerization of IT.

If you want to as we do then, to capture a large user base, real people who use our products in many aspects of their life, you must focus either on consumer services, devices or some combination. I would say that in many ways we are coming at both of these. But devices are particularly important as a place to capture and really involve the end-user and frankly the devices, while we continue to pursue service opportunity. And we see great opportunities particularly for revenue upside in our Bing service. The device opportunity is perhaps the best opportunity for pursuing users in very, very large numbers.

The phone as a device is, of course, obvious. It's the most popular device, intelligent device, now on the planet. It is important for us to really make sure we have the innovative high quality experience that lights up on great devices. We do think that

there will be innovation in hardware and in software. And that will give opportunities for us to build market share in the phone as a device. And that brings with it profit opportunities. I continue to believe that there is enough innovation in devices, unlike some of our investors, that it will be a growth opportunity in terms of the financial reward to the bold, to the innovative who pursue it.

We will, as we do today, we will support both iPhone and Android Galaxy phone with our services. We are not holding back services from other phone vendors, platforms in any way. On the other hand, we cannot do a full and first-class experience on those platforms. The level of integration, the level of device support, the level of economic tax taken by the platform vendor, all of those things. We run the risk that Google or Apple will foreclose our ability to innovate, to integrate our applications, the way that we have an office, to do distribution or to impose economic terms. For all of those reasons, not only in an offensive aspect but in a defensive aspect, we think it's very important to have an absolutely first-rate Microsoft phone experience with integrated software and services.

We're not new to devices. There will be over 300 million Windows devices sold this year. Certainly as I talk to our hardware partners in PCs and tablets they agree with me passionately that success in phone is important to success in tablets. And I've already had a chance to talk to a number of our big OEMs who are excited about the transaction that we are announcing today with Nokia. We also know that there is a relationship between tablets and PCs. In some senses. And in successful investment Windows Phone and Windows ecosystem should help raise the tide of everything that we do. We know that that rising tide attracts application developers. And we recognize the gaps we have in application ecosystem today, particularly on Windows Phones.

On slide 15, I want to talk a little bit about why we think we need to do our own phone hardware and what the ongoing opportunity is for our OEM partners. As we discussed, Windows Phone has achieved the number three position in smartphones globally. Some of you say three is not two and not one. I will tell you, you cannot get to be two until you are three. And we will work very hard on the opportunities that are in front of us. But what it means is we have the smallest share of the real contenders. And today a very high concentration, over 80% of the Windows Phone business is already with Nokia. And so in terms of evaluating paths that would ensure that we continue to see great Windows Phone devices from the Nokia team. And in an attempt to really ask what's the most sensible economic model, it made sense for us to go first-party, have our own phones to ensure a Windows Phone presence.

We looked at various OEM alternatives, continuing an OEM-only model. Those actually looked prohibitively expensive from a marketing standpoint. And this actually looks to us to be the best risk-return and upside opportunity for our shareholders. Terry talked about why an acquisition is better than continuing from an innovation and marketing standpoint and arm's length relationship with Nokia. So we think the combination gives us the maximum opportunities and Amy will talk some about that from a financial perspective.

We absolutely believe this acquisition grows our OEM opportunity. More success with phones helps our OEMs and tablets and PCs. I talked to a number of OEMs who are more enthusiastic today than they were yesterday about pursuing phones, because they know we have a flagship product with which to blaze trails in this market. And there is plenty of opportunity for OEMs to address the diversity of markets that are out there. I am pretty excited. It's a different model than the PC model. But I am pretty excited about the way in which we can balance our own first-party hardware and get support and help that's important from our OEMs.

On slide 16, in some sense of the question is why Nokia? Of we are going to do phone hardware there is absolutely no question in my mind that Nokia is a first-rate Company when it comes to device design and engineering. We know that from working with their teams and seeing their products, device distribution and sales, supply chain, operational processes, hardware distribution. They can do that today all with Windows Phones. I think there is no question that if we are going to need to be and want to be a scale player in hardware, having a culture, a set of processes, a set of talent and people who really know how to run a first-rate hardware business, is essential. We certainly think we have many talented hardware engineers. But we have a very, very capable team, a team that ships as many electronic devices as almost any Company on the planet, now becomes part of Microsoft. I'm very excited to welcome the Nokia team. I'm traveling in Finland for the next few days meeting people beyond the leadership team and I think it's really exciting to see the team that's here.

Finally, I want to talk a little bit about high-value services. Nobody buys hardware for hardware and it's sometimes hard to get real end-users to buy services without buying hardware. So we think about, as I said, devices with services and with office, with Skype, with Xbox Entertainment Services, SkyDrive, Bing, we have a powerful line-up of first rate services to deliver on high value experiences. But in the mobile world mapping is essential. And we need a very effective alternative for mapping to Google. It is important to many players including Microsoft, that there be more than one digital map of the world.

What we're doing in the partnership today, what we'll do, sorry, with transaction, Microsoft will get flexibility to integrate Nokia's HERE geospatial assets into all of our experience. We have great freedom to innovate around the HERE location platform. And yet Nokia can maximize the use of the HERE asset by other industry players. Like every other aspect of the deal being announced today, we examined many possibilities and collectively decided that the new partnership is simpler, more effective. And more likely to lead to economic success for both entities. And a real second digital map of the world. We will become, with the conclusion of this transaction, we will become a top three customer for Nokia. Those economics are outside the acquisition economics that we summarized in the sheet. But they're in the analysis that Amy Hood will now share with you. Amy, you want to talk some about the smartness. So to speak, of this acquisition?

**Amy Hood** {BIO 18040963 <GO>}

Absolutely. Hello, everyone. As Steve and Terry have both mentioned, today is a very exciting day for Microsoft. We feel great about the opportunity that this deal represents to drive long-term shareholder value with both top; and bottom-line growth.

As we turn to slide 19, let me get into a few specifics of the deal. There are really two primary components. First, we are paying EUR3.79 billion for Nokia's Devices & Services business, which includes thousands of design patents, key brands. And the benefit that we receive from Nokia of signing its patent licenses with third party's Microsoft. Additionally, EUR1.65 billion is being paid to license Nokia's broad intellectual property portfolio for ten years with an option to convert to a perpetual license. We consider this portfolio to be among the best in the mobile industry and we will be able to leverage it across Microsoft's entire portfolio of products. Brad will cover the details on these key assets in a few minutes.

The combined purchase price will be paid using offshore cash. We do not believe that this transaction will impact our ability to continue to return cash to shareholders. In addition to the Lumia brand of products, an important component of Nokia's Devices and Services business is the scale and breadth of their Asha branded phones and other phones developed by the mobile phone business units. Nokia sold over 53 million mobile phone units in the Second Quarter. And their strength in growth markets creates unique opportunity for Microsoft to reach these users as they transition the smartphones. Many of Nokia's strongest smartphone markets are places where the mobile phone business was a key part of that foundation.

Now to slide 20. Earlier, Terry walked through some of the benefits that we'll gain from this deal, particularly from an engineering and go-to-market perspective. Additionally this deal affords us greater economic opportunity. Under the commercial deal that was in place, we were capturing less than \$10 per device in software royalty gross profits, then making platform payments to Nokia and investing in sales and marketing support to grow the business. By owning the devices and services business, Microsoft will now be able to capture and utilize the entire gross profit of the device, which for Lumia was about \$40 per unit in Nokia's most recent quarter. Using assumptions that are in line with industry forecasts and current performance and trajectory, after it is integrated into Microsoft we estimate that we will achieve operating income break-even for this business when we sell approximately 50 million smart devices a year. For reference, Nokia sold over 7 million units last quarter, up 32% sequentially. As we continue to drive further scale, the per-unit profitability is significantly better for us with this acquisition.

Now to slide 21. We expect this deal to have a negative \$0.08 impact on and adjusted basis and \$0.12 impact to GAAP earnings per share in fiscal 2014, based on a close date in early calendar 2014. Adjusting for acquisition-related amortization and integration expenses, we expect the deal will be accretive on a non-GAAP basis in fiscal year '15, driven by both increased smart device unit volumes and cost synergies. Cost synergies are expected to occur across both Companies over a wide variety of functions. We are committed to operating this business efficiently. As Steve mentioned, Nokia brings significant expertise in areas such as supply chain and



demand planning. And has mature operational systems in place that will be a key asset for the combined entity.

On slide 22, with this deal we have a real opportunity to materially drive long-term shareholder value. The smartphone market is expected to reach over 1.7 billion units a year. And as Steve and Terry discussed, this acquisition better positions our Company to compete in that market. The directional values presented here are those directly related to the acquired Devices & Services business. In addition, we believe there are opportunities to create additional value with a positive impact on our family of devices, particularly tablets but also PCs, along with our portfolio of business and consumer services. Those impacts are not included in these numbers.

Before I hand it off to Brad, let me leave you with this. With this acquisition, we have an opportunity to fundamentally change the economic structure of our mobile business. It is a change that, as the business grows, presents an opportunity to deliver enhanced economics with significant additional benefits to other businesses across the Company. With the commercial deal showing positive early momentum and both Companies assessing their strategic positions, this was the right time to make this deal. And with strong execution, it is an acquisition that can deliver significant economic return. Now let me hand it off to Brad, who is going to talk through some of the details regarding the patents and the intellectual property.

**Brad Smith** {BIO 1721351 <GO>}

Thanks Amy. And hello, everyone. Let me turn to slide 23 and talk a little bit about the IP aspects of this. If you step back and think about it, it's pretty self-evident that an important part of managing a smart devices business well involves management of intellectual property rights. Anybody who reads the news will see that if you don't do a good job, you will run the risk that you infringe other people's patents, your shipments can be enjoined. Even if you are able to secure licenses, if you are not creative in the way you put all of this together, you can drive up your costs. And indeed for some companies, the patent costs amount to 10% or more of their bill of materials. For other companies that's substantially lower. We put a lot of thought as we have structured this transaction and considered the Company's strategic opportunities at addressing the patent issues.

If you look at what we are getting in this agreement it really breaks down into a few pieces. Number one, there are some IP assets that are being transferred from Nokia to Microsoft. This includes about 8,500 design patents. These are the patents that distinguish the physical features of a product from another product. It includes the transfer of two important brands, the Asha brand and the Lumia brand. We secured a ten-year license to use the Nokia brand on feature phones. That is what is being moved over in terms of ownership.

Second there is a patent license for which Microsoft is paying EUR1.65 billion. This involves the right to, in effect make, use of Nokia's inventions. It doesn't involve the transfer or ownership of the patents itself. But what it does give is, it gives Microsoft a license for all of Nokia's patents except for the NSN patents. It gives us the option,

which we'll exercise, to convert this license from a ten-year license to a perpetual license, meaning we'll have patent coverage for the life of all those patents. It also has a broad five-year, two-way standstill between both Companies including the NSN patents.

One of the reasons we focus so much on securing this license, one of the reasons it has a high price tag is because of the very substantial value of Nokia's patent portfolio. When we look at the industry. And in particular when we look at patents that are relevant to wireless connectivity, using the CDMA standard or the GSM standard or 3G or 4G technologies, we really believe that Nokia has one of the two most valuable portfolios in the industry. The other is Qualcomm's. So we secured the right to use those patents as we produce and innovate in this device space going forward. There's also some significant value for our existing business. We have been making annual patent royalty payments already to Nokia for our existing businesses. And we assign roughly a quarter of the value of the EUR1.65 billion patent license to these existing businesses.

If you go to slide 24, you see the other part of what is a very significant aspect of this transaction. In our view, Nokia has been one of the smartest, I'd go as far as to say the most sophisticated and smartest device Company, in securing the patent rights it has needed to produce smart devices, smartphones. And under this agreement, the benefits of over 60 patent licenses that Nokia has negotiated with third parties are assigned to Microsoft. The most important of these is with Qualcomm. Nokia reported publicly that it negotiated a 15-year license that went into effect in 2008 with Qualcomm. It paid EUR1.7 billion. It also transferred to Qualcomm a number of Nokia patents. As a result, Nokia has what we regard as an important and attractive patent arrangement in place with Qualcomm. We now benefit from that arrangement.

But it's not Qualcomm alone. There are a number of other important third parties as well from which we'll now get the benefit of the existing licenses. We get to combine that with the license agreements we have been putting in place over the last few years. And typically over the last few years as we have negotiated patent agreements with other companies, we have bargained for the right to produce devices if we wanted go that route. So our existing agreement with Samsung gives us coverage under Samsung's patents without paying additional money. The same is true for a number of other patent agreements that we have in place. When you put all of this together the IP assets that are transferred, the Nokia patent license, the patent licenses that are transferred from Nokia to Microsoft, we believe it puts us in the position to have the most cost-effective patent arrangements for any Company in the smart devices space.

### **Steve Ballmer** {BIO 1390481 <GO>}

Great. Thanks very much, Brad. I am going to turn to slide 26 and talk some about the execution plan. One of the things which I think we are most acutely focused in on, is how do Companies really make big acquisitions work? In this case, we have two and a half years now of experience in making many aspects of this acquisition work. Our partnership provides us with great confidence. We know the people. We

can produce products together. We know how to go to market together. We can do it all more efficiently. We understand that. More effectively, we understand that. I have to say I don't know whether we would be here if we hadn't already operated under our current collaborative agreement do so much great work.

So building on the existing partnership and the structure of the deal, I spent time with Nokia's senior team on the Devices and Services side as is Terry Myerson and others, as part of the transaction. And associated with the transaction, Stephen Elop and, frankly, most of the leadership team from Nokia on the Devices and Services side is signed up, excited, moving over to Microsoft. So that we have the opportunity to execute on this without missing a beat. The leader of the Smart Devices side, the Mobile Phone side, the talent and expertise that Juha brings in operations, Chris Weber who runs the field, all intact. Stefan Pannenbecker, who has done some of the most important design on Lumia, joins as part of this deal. We'll hear from Stephen Elop in just a moment.

We have a structure for the integration that makes sense to us. Steven will run our Integrated Devices organization and his team on the engineering and supply chain side will come with him. And will be the center on which we integrate Devices. And supply chain will be with Stephen. Our Phone device R&D will be centered here in Finland. We will consolidate marketing as well as the development of software services. The Nokia sales team, importantly, will stay intact. We need that team out there everyday, not only just to close but post-close, really generating sales through the relationships with the operators. And we think we've got a good plan there. We have integration executives mobilized on both sides. Tom Gibbons, who has been with Microsoft over 20 years in a variety of hardware and software aspects of our business will lead, as will Juha Putkiranta on the Nokia side. Then as I said, we have working rhythms between the two Companies that are intact. I'd like to turn things over to Stephen Elop, who will lead the Microsoft devices effort post-closing. And is currently, as of yesterday was CEO of Nokia and now is EVP of the Devices division of Nokia. Stephen.

## **Stephen Elop {BIO 3600175 <GO>}**

Thank you, Steve. I'm glad to be able to join you on the call today. At Nokia we've been building momentum around our Lumia products steadily over the past four quarters. We've continued to connect the next billion people with new advances in our Mobile Phones business. We have been going faster than Nokia has ever gone before and as other manufacturers have fallen by the wayside or gone sideways, achieving our goal of becoming third ecosystem is becoming very real. That is one of the reasons Nokia and Microsoft have entered into this transaction.

We believe this transaction will accelerate the momentum of the Devices and Services business. By bringing our teams together we can increase our share in smart devices through faster innovation, through better products and through unified branding and marketing. In short, we can reduce the natural frictions in the system between our two Companies. We can invest more resources into the effort and we can build on the momentum that has already been established. As well, the potential for what we can do with mobile phones goes up, as we are presented with

the opportunity to bring a rich array of Microsoft services to first-time smartphone users. And as we create an on-ramp to Windows Phone for people that are having their first smart experiences. Our likelihood of success with Devices & Services goes up as a result of this transaction.

When Steve and I first discussed the original partnership between Nokia and Microsoft in early 2011, we spent a lot of time focused on designing how our Companies would actually work together. We put in place the organizational structures and management rhythm necessary for our teams to jointly design and engineer the award-winning products that we have since delivered. Our collective teams have now had two and a half years of experience with working together side by side every single day. This represents a huge advantage as we enter this transaction, because we already know each other. We have learned how to solve problems together. And we continue to share the same broader goals.

That experience with Microsoft combined with our passion to win with our strategies, has allowed us to confirm that we will be bringing a very talented and motivated team across to Microsoft. For example, Jo Harlow will join Microsoft and will continue to lead Smart Devices. Timo Toikkanen will join Microsoft and will continue to lead Mobile Devices. Juha Putkiranta will join Microsoft and will lead the integration effort between our Companies on behalf of Nokia, while continuing to lead operations for us. Stefan Pannenbecker will join Microsoft and will lead design. Chris Weber will join Microsoft and will lead the devices sales team, with the Nokia sales team being the nexus for Microsoft's devices sales team going forward.

And as we speak, dozens of other leaders at Microsoft have already confirmed their commitment to the success of this next chapter and are, as we speak, helping everyone else at Nokia through what is an emotional period of time. I will be focused on leading the talented and passionate teams of Nokia through this transition. I'll concentrate my efforts on the months immediately ahead on the Devices and Services business within Nokia. And when the transaction with Microsoft closes, I too will transfer to Microsoft and become the EVP of Devices. We have exciting innovation across Nokia's Smart Devices and Mobile Phones. And with a strong plan for execution we can accelerate the current momentum to be a more successful leader in the mobile market. Thank you, Steve.

### **Steve Ballmer** {BIO 1390481 <GO>}

Thanks, Stephen. I just want to underscore one point before I pass things to Brad to talk about regulatory, which is the next step. I am incredibly proud of the products that we have produced with Nokia. The Lumia Windows Phones in market are some of the best products Microsoft has ever built in terms of capability, design, quality. We are very, very firm in our commitment and belief. We have work to do to establish even greater differentiation. We have work to do on the so-called application gap. We have work to do for market success. But we have created absolutely first-rate products of which we are all at Nokia and Microsoft incredibly proud. And we will continue that as we move into this new space. Brad, why don't you talk a little bit about regulatory approval?

---

**Brad Smith** {BIO 1721351 <GO>}

Sure. Thanks, Steve. As an acquisition involving two global Companies, not surprisingly this involves merger review by a number of governments and regulatory authorities around the world. So we'll be moving quickly to submit this for the requisite approval in the European Union, the United States, in China, in countries such as India, Brazil, Russia, Canada, many others. We're confident that we'll secure regulatory approval in the first calendar quarter of 2014.

And I think the basis for our confidence is pretty clear. Number one, this is an instance where you really see complimentary assets coming together. Microsoft and Nokia are not competing in this space today. In fact we are already partners that are collaborating. And the essence of the rationale for regulators is clear as well. We will be more effective as a competitor in the market by bringing all of these strengths together and by operating separately or through this partnership in two different Companies. We get to bring together the new capabilities to Microsoft that Nokia has really excelled at over the years. That includes everything from design and manufacturing and inventory and supply chain management, to the other aspects that are critical to being in the devices business. That will make us more effective. As Amy pointed out, the economics will enable us to be more effective.

In short, we will be a stronger number three. And regulators like it when the number three competitor in a market has a better opportunity to challenge the two market leaders. And at the same time, as Steve has highlighted, we are committed to continuing to work with our partners in the Windows and Windows Phones ecosystems. Indeed, we believe our success in phones will help our partners when it comes to other areas, especially tablets and PCs. Ultimately as we all know, regulators quite rightly look first and foremost at what a deal will mean for consumers. In this instance, we believe emphatically that this is good news for consumers. By bringing together hardware, software and IP licenses, we are in a position to drive down our cost. We are in a position to accelerate innovation. We are in a position to offer consumers more choice, better innovation and stronger products. That in short, is what regulators look to approve. That's why we're confident we'll secure approval for this.

**Steve Ballmer** {BIO 1390481 <GO>}

Fantastic.

**Brad Smith** {BIO 1721351 <GO>}

Steve, back to you.

**Steve Ballmer** {BIO 1390481 <GO>}

Chris, I think that pretty much wraps up. And we would love the chance to take some questions.

## Questions And Answers

### Operator

Walter Pritchard, Citigroup.

### Q - Walter Pritchard {BIO 4672133 <GO>}

Steve Ballmer, on the tablet side, obviously we could say as many of the same things as you put into the slide deck as rationale for doing an acquisition on the phone side is, as we could say about the tablet side including picking up more gross margin. I'm wondering how this transaction impacts the strategy going forward in tablets? And whether or not you need to, in a sense, double down further on first-party hardware in the tablet market. Then just had one follow up.

### A - Steve Ballmer {BIO 1390481 <GO>}

Okay. Terry, do you want to talk a little bit about that? That would be great.

### A - Terry Myerson {BIO 17496274 <GO>}

Phones and tablets are definitely a continuum. We see the phone products growing up the screen sizes and the user experience we have on the phones. We have now made that available on our Windows Tablets. Our application platform spans from phone to tablet. I think it's fair to say that our customers are expecting us to offer great tablets that look and feel and act in every way like our phones. We'll be pursuing a strategy along those lines.

### A - Steve Ballmer {BIO 1390481 <GO>}

Tablets is an area where we absolutely have our own first-party hardware, as you know. And see opportunities to continue to build and strengthen. And it's an area where we have very strong programs in place with our OEMs, particularly on the Intel Atom processor-based product lines that I think people will really get a lot of value on. And you will see a range of new products coming for the holiday season.

### Q - Walter Pritchard {BIO 4672133 <GO>}

Then, Terry, can you talk about the ability to scale Windows down? Obviously Nokia has a large base of very low-priced feature phones. That base may be dwindling over time. You have been cost reducing Windows, the specs and so forth, to be able to get Windows down to low-priced devices. Can you talk about any efforts to accelerate that process, given potentially access to a much bigger pool of low-cost phones that are out there already?

### A - Terry Myerson {BIO 17496274 <GO>}

It's definitely a priority for us to bring Windows to as many customers as we can around the world. The lower price phone is a strategic initiative for the next Windows Phone release. We have nothing more really to say now.

**Q - Walter Pritchard** {BIO 4672133 <GO>}

Okay. Thank you.

**A - Chris Suh** {BIO 17955231 <GO>}

Operator, we'll move to the next question, please. Thanks, Walter.

**Operator**

(Operator Instructions)

Mark Moerdler, Sanford Bernstein.

**Q - Mark Moerdler** {BIO 16855032 <GO>}

Steve Ballmer, two questions. The first is how does this affect the re-org? Given hardware was in one group and operating systems in another, software in another, does the Nokia device, does the merger affect that? Does it merge into the hardware business and hardware/content device group? Or does this now change that? Then I have a follow up.

**A - Steve Ballmer** {BIO 1390481 <GO>}

The re-org is absolutely intact. Obviously the Devices business has a broader scale and new capability. Julie Larson-Green, who is running devices and studios is flat out. We've got a lot of work we are doing here over the next several months and Julie and her team will work on a planning and integration phase. Julie will continue. She's excited about working on devices. But absolutely the critical mass of the group with this acquisition is in the phone space and Stephen Elop will run the group and will take the appropriate steps, with Julie working with Steven to figure out appropriate integrations.

**Q - Mark Moerdler** {BIO 16855032 <GO>}

Excellent. Then as follow up on it. What's your expectation going forward in terms of, want to clarify this, the percentage of Windows Phones that will be from OEMs?

**A - Steve Ballmer** {BIO 1390481 <GO>}

Today Nokia, as I said, is well over 80% of all of our phones. I don't perceive that changing dramatically in the short run. But as the market grows I expect to see additional percentages, if you will, go to our OEMs. But it's premature to predict today. We definitely have interest from OEMs in the Windows Phone opportunity, given that people understand we're going to blaze the trails here with our own first-party hardware.

**Q - Mark Moerdler** {BIO 16855032 <GO>}

Thank you very much. Appreciate it.

**A - Chris Suh** {BIO 17955231 <GO>}

Thanks, Mark. I want to remind you, we want to get to as many questions from as many of you as we can. So I do ask that you please just stick to one question and avoid long multi-part questions, please. Operator, next question, please.

**Operator**

Brent Thill, UBS.

**Q - Brent Thill** {BIO 1556691 <GO>}

On the cost rationalization, Nokia at 32,000 employees versus Microsoft's at 99,000, a considerable bulk of employees. Can you talk about the rationalization over time and your view how that plays out.

**A - Steve Ballmer** {BIO 1390481 <GO>}

Amy will take it. I do want to highlight that in many hardware companies manufacturing labor is primarily outsourced. Amy can remind us the numbers but in Nokia there is more in-source manufacturing. Nokia's had a strategy about that that is, obviously they've executed very well. You have apples and oranges a little bit between the 32,000 and our almost 100,000. Amy, why don't you provide some context and detail?

**A - Amy Hood** {BIO 18040963 <GO>}

Sure. Thanks, Brent. About 18,000 of those 32,000 employees are really directly a part of the manufacturing business. And so I think a better way as you think about the scale and opportunity, is to really focus on the percentage of Nokia outside of that. I actually think both Steve and Stephen did a thoughtful job in the execution slide about talking really about the philosophy we're using as we go through the integration process around the benefits of the incremental sales force that we're getting with Chris and his team, as well as really going through and being thoughtful about the rationalization so that we get to one voice, one brand, one team that can best execute and be efficient.

**A - Chris Suh** {BIO 17955231 <GO>}

Thanks, Amy. Next question please, operator.

**Operator**

Keith Weiss, Morgan Stanley.

**Q - Keith Weiss** {BIO 6993337 <GO>}

You guys have talked about the success in the partnership to date and putting out some really good products. I was wondering, Steve, perhaps you could give us some concrete examples. What does the acquisition enable you to do that you guys couldn't do through the partnership? Maybe give us some more concrete examples



there. Or is that maybe not the point? Maybe the point is more so that this really solidifies Microsoft's presence in the smartphone market. It's more about ensuring that you guys are going to be a presence here for an ongoing, for a longer-term basis?

**A - Steve Ballmer** {BIO 1390481 <GO>}

While the latter is certainly true, we see at least three distinct opportunities to do better as one Company than as two. Number one, we talk about one brand in a unified voice to the market. I will say that I think we can probably do better for consumer name than the Nokia Lumia Windows Phone 1020. And yet because of where both Companies are and the independent nature of the businesses, we haven't been able to shorten that. Just take that as a proxy for a range of improvements that we feel we can make. We can simplify the way in which we work with operators and the overall consumer branding and messaging gets much simpler. That is an efficiency of being one Company.

On the innovation front we've done a lot of great work together. Yet as two Companies, there is always some lines along which it's hard to innovate. The Lumia 1020 is awesome in terms of what it has for camera and imaging. And yet, I think, as one Company we would have doubled down on that and made an even greater range of software and services investments around the core hardware platform. Third, I think we get business agility. As two Companies we're making two independent sets of decisions about where and when and how to invest by country, by operator, by price point. There is, let me say, an inefficiency financially as well as lack of agility that comes with that. So in all three of those areas, despite the fact that I think we've done a really good job, we can improve and accelerate quite noticeably.

**Q - Keith Weiss** {BIO 6993337 <GO>}

Excellent. Thank you.

**A - Chris Suh** {BIO 17955231 <GO>}

Thanks, Keith. Operator I think we have time for two more questions. Next question, please.

**Operator**

Rolfe Winkler, Wall Street Journal.

**Q - Rolfe Winkler**

You guys have 15%, a fairly aggressive market share assumption for where you guys are going go in a few years? I am wondering, to get there one thing you are going to need is a lot of developer support. Developers already have IOS Android. You can make an argument that HTML size over the next few will grow. That will give them a third development platform. How will you guys convince them to develop for Windows Phone?

**A - Steve Ballmer** {BIO 1390481 <GO>}

Terry, why don't you talk a little bit about developers if you don't mind.

**A - Terry Myerson** {BIO 17496274 <GO>}

For developers today, Windows offers an incredible opportunity with the install base of PCs, phones and tablets and soon the new Xbox One. We want to offer them this opportunity to build either HTML5 applications or native applications that span all those devices, enabling them to reach segments of users on those devices, users in an enterprise, users on a gaming console; and just provide them very unique opportunities to monetize their application investment. We are pretty excited about the platforms we are bringing to market. Developer reception in some areas is certainly better than others. But overall we are making progress. We know we've got a lot more work to do.

**A - Steve Ballmer** {BIO 1390481 <GO>}

One of the keys, of course, is driving volume. We think we have differentiated products. We can tell the story a little bit better. We get volume up. We have over 160,000 applications in the store. We know we have a long way to go. The key is really offering, with our own first party applications and first party hardware, enough reasons to buy, to drive volumes and then attract a broader developer ecosystem. Obviously HTML5 would be a neutral thing. I would expect all the major platforms to embrace it to some extent. And in some senses it takes away a little bit of the app's barrier to entry, which we know we need to work hard on right now.

**A - Chris Suh** {BIO 17955231 <GO>}

Great. Thanks. Operator, let's move to last question, please.

**Operator**

Rick Sherlund, Nomura Security.

**Q - Rick Sherlund** {BIO 1504922 <GO>}

I am wondering if you could share with us whether ValueAct was made aware of this before they entered their cooperation and standstill agreement?

**A - Steve Ballmer** {BIO 1390481 <GO>}

Brad, you want to take that?

**A - Brad Smith** {BIO 1721351 <GO>}

The answer is no. You would not expect the Company to disclose material non-public information to an entity that doesn't have an appropriate nondisclosure agreement. So the answer is no.

**Q - Rick Sherlund** {BIO 1504922 <GO>}

Okay. Thank you.

**A - Chris Suh** {BIO 17955231 <GO>}

Okay. So that will wrap up our call today. Thank you, again for joining us. We look forward to seeing many of you at our financial analysts meeting, which will be held on September 19. Thanks again.

**Operator**

This does conclude the conference for today. All participants may disconnect at this time. Thank you.

*This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2024, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.*