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QUALCOMM, Inc. (QCOM)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the QUALCOMM Second Quarter Fiscal 2019 Earnings Conference Call. [Operator Instructions] Please limit your questions to one question and one follow-up. As a reminder, this conference is being recorded May 1, 2019. The playback number for today's call is 877-660-6853. International callers please dial 201-612-7415. The playback reservation number is 13689810.

I would now like to turn the call over to Mauricio Lopez-Hodoyan, Vice President of Investor Relations. Mr. Lopez-Hodoyan, please go ahead.

Mauricio Lopez-Hodoyan

Vice President, Investor Relations, QUALCOMM, Inc.

Thank you, and good afternoon everyone. Today's call will include prepared remarks by Steve Mollenkopf and Dave Wise. In addition, Cristiano Amon, Alex Rogers and Don Rosenberg will join the question-and-answer session. You can access our earnings release and a slide presentation that accompany this call on our Investor Relations website. In addition, this call is being webcast on qualcomm.com and a replay will be available on our website later today.

During the 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. We will also make forward-looking statements, including projections and estimates of future events, business or industry trends, or business or financial results. Actual events or results could differ materially from those projected in our forward-looking statements. Please refer to our SEC filings, including our most recent 10-K, which contain important factors that could cause actual results to differ materially from the forward-looking statements.

And now to comments from QUALCOMM's Chief Executive Officer, Steve Mollenkopf.

Steven M. Mollenkopf

Chief Executive Officer & Director, QUALCOMM, Inc.

Thank you, Mauricio, and good afternoon everyone. Thanks for joining us today. We are pleased to report another strong quarter. Our fiscal second quarter non-GAAP earnings of \$0.77 per share exceeded the high end of our guidance range, driven by higher licensing revenues and stronger QCT margins. As we look forward, the rest of the fiscal year will be impacted by a slower market for devices, particularly in China, upstream of the larger rollouts of 5G worldwide.

Two weeks ago, we announced the global settlement of our disputes with Apple and its contract manufacturers. We believe the settlement is a win for both companies and we are pleased with the result and pleased to have it behind us. Dave will provide more details on the financial impact of this settlement in his prepared remarks. But at a high level, this settlement includes two long-term agreements with Apple, a global patent license agreement and a multi-year chipset supply agreement. The settlement also includes a one-time payment from Apple to QUALCOMM.

The term of the global patent license agreement is for six years with an option for Apple to extend for an additional two years. This represents a significant milestone, as it is QUALCOMM's first patent license agreement

directly with Apple. In addition, we believe our resolution with Apple enhances our position with respect to resolving our ongoing licensing issues with Huawei.

We will also be supplying modems to Apple for future devices under the terms of our new multi-year chipset supply agreement. In the long term, we will also have the opportunity to provide Apple with other QUALCOMM technologies and products to expand our dollar content share in Apple's products, as we have done with our other handset OEMs. We are committed to a strong partnership with Apple.

Now that the dispute with Apple is behind us, I thought it'd be helpful to describe how we are thinking about the positioning of the company going forward. First, 5G will be a significant opportunity for QUALCOMM, both within cellular and in other industries. It is the key technology enabler for the future of the Internet and having a strong and differentiated technology position is an important asset for our shareholders.

This past quarter was a tipping point for 5G when in February, at Mobile World Congress, representatives from major Android device manufacturers, network operators and infrastructure providers joined QUALCOMM in celebrating our collective achievement in bringing 5G to life.

Since that event, I am pleased to report that the rollout of 5G has officially begun. In the last months, we have seen carriers and OEMs announce and launch commercial 5G services and devices in North America, South Korea, Europe and most recently China, representing the first global rollout of a new wireless standard.

The arrival of 5G in China is particularly exciting as it brings 5G to the largest mobile user base in the world. To-date, the vast majority of the announced 5G devices for China include QUALCOMM's Snapdragon chipsets.

Second, we enter into the 5G era with strength in products, a favorable competitive dynamic and more customer diversity and technology breadth than in earlier generations of cellular. This is due to QUALCOMM's continued focus on investing in innovation and R&D during a time of much activity and attention on our company.

We've transformed QCT by diversifying our customer base, focusing our investments and streamlining our cost structure. Our year-to-date non-Apple QCT operating income doubled compared to a two year-ago period, putting us in a strong position to grow revenues and profits as we begin ramping 5G in addition to supplying Apple under this new agreement.

As 5G network launches continue to grow, so does our QCT design win pipeline. We now have over 75 5G design wins, more than double the number we announced last January, driven by OEM designs with our first and second generation 5G modems.

In February, we announced our second generation 5G modem, the Snapdragon X55, our second generation 5G RF front-end solutions and the world's first mobile platform with integrated 5G, all of which position us to power the second wave of 5G devices launching in late-2019 and early-2020 to drive mainstream adoption of 5G.

Our early investments in 5G now allow us to offer the world's first modem-to-antenna system for commercial 5G new radio smartphone devices, spanning millimeter-wave and sub-6 gigahertz bands, including baseband, RF transceiver, RF front-end components and millimeter-wave antenna modules. This systems approach is creating a benchmark for 5G RF front-end performance. QUALCOMM is heavily engaged as a critical partner to leaders across many industries as they see 5G mobility as a foundational technology for their digital transformation.

Third, our cost structure and investment focus are aligned with the opportunities ahead. We will continue to invest where we can leverage our core competencies and bring innovative solutions to large markets. In 5G, this presents opportunities for growth in our core cellular market in addition to many adjacent industries as they leverage 5G to accelerate their digital transformation.

In summary, with our agreements with Apple, the beginning of the 5G ramp, our focus on operational execution and capital return, we think we've laid the groundwork for growth in revenue and EPS and stockholder returns over the next several years.

As a management team, we are committed to driving stockholder value by taking thoughtful and deliberate actions that we believe will ensure the long-term growth of our company as you have seen.

We appreciate the positive reaction from investors and analysts to our recent announcement with Apple, especially the feedback from many stockholders over the last two weeks who have recognized and appreciated our commitment to sustaining QUALCOMM's long-term differentiation and focus on technology and innovation.

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

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

Thank you, Steve, and good afternoon, everyone. We are pleased to announce strong second quarter results with GAAP revenues of \$5 billion, above the midpoint of our guidance range; and non-GAAP EPS of \$0.77, \$0.02 above the high end of our range.

The outperformance in the quarter was primarily driven by QTL revenues of \$1.12 billion that were positively impacted by approximately \$100 million of out-of-period catch up offsetting some impacts from overall market weakness.

Additionally, we saw improved QCT gross margins and operating expenses which came in lower than expected. QCT revenues of \$3.7 billion were in line with expectations. MSM shipments of 155 million units were within the guidance range, but below the midpoint, reflecting overall weakness in global device shipments.

QCT EBT margin was 14.6% for the quarter, at the high end of our prior guidance range driven by improvements in gross margins. Please note results this quarter do not contain any contributions from the settlements of our disputes with Apple and its contract manufacturers.

Turning to our global 3G/4G/5G device forecast. We are lowering our estimates for calendar 2019 by another 50 million units at the midpoint to 1.85 billion units due to continued weakness in China and a lengthening of handset replacement cycles, potentially reflecting a pause in advance of 5G rollouts. We now expect global handset units to decline slightly year-over-year, offset by continued growth in non-handsets resulting in total overall unit growth of approximately 3% at the midpoint.

In regards to our recently announced Apple agreements, we expect to record revenues resulting from the settlement of matters prior to the effective date of the agreement of \$4.5 billion to \$4.7 billion in our third fiscal quarter. This includes a cash payment from Apple and a release of related liabilities. The settlement amount will be excluded from our non-GAAP results.

Our guidance for the third fiscal quarter, we estimate GAAP revenues to be in the range of \$9.2 billion to \$10.2 billion; and estimate GAAP EPS of \$3.57 to \$3.77, which includes the revenues related to the settlement with Apple and the contract manufacturers. We estimate fiscal third quarter non-GAAP revenues to be in the range of \$4.7 billion to \$5.5 billion and non-GAAP EPS to be approximately \$0.70 to \$0.80.

For QTL, we expect revenues to be between \$1.225 billion and \$1.325 billion including the addition of ongoing Apple royalties, offset by a relatively modest impact from previously discussed market weakness and impacts from OEM mix. This compares favorably to the second quarter QTL revenues, which after adjusting for approximately \$100 million of greater than expected catch-up revenues, was about \$1.025 billion.

As a reminder, our third quarter guidance includes the last \$150 million payment under the interim agreement with Huawei. We expect QTL EBT margin to be 65% to 69%, up sequentially, reflecting the inclusion of Apple licensing revenues and modestly lower litigation expense.

In QCT, we estimate 150 million to 170 million MSM shipments for the third quarter and EBT margins between 13% and 15%. QCT is also being negatively impacted by overall market weakness, unfavorable OEM mix shift, including share shift towards Huawei and near-term impacts to adjacent businesses from economic weakness in China.

With respect to the cost plan, we have completed and achieved substantially all of the target \$1 billion savings based on our second quarter run rate excluding excess litigation costs.

For our third fiscal quarter, we expect non-GAAP combined R&D and SG&A expenses to increase 6% to 8%. About 6 points of the sequential increase reflects an increase in our employee bonus plan as the result of the impacts of our Apple settlements.

Litigation expense savings are expected to be modest in the third quarter given expenses incurred in advance of the resolution with Apple and its contract manufacturers as well as continuing costs related to the ongoing regulatory actions in the U.S., Korea and EU.

In our fiscal fourth quarter, we expect further litigation cost savings, partially offset by investment in our employees. Longer term, we expect litigation cost savings to be somewhat offset by increased investment to support Apple product ramp.

Turning to our tax rate. We estimate our third quarter non-GAAP tax rate to be approximately 14% to 15% and expect it to be a good proxy for the remainder of the fiscal year.

As an update on our share repurchase activity, as of May 1, we have completed approximately 65% of the ASRs at an average price of approximately \$61 per share. As a reminder, we expect to complete the ASRs into early September. We are estimating 1.23 billion weighted average shares outstanding for the third fiscal quarter and approximately 1.2 billion weighted average shares outstanding for the full year fiscal 2019.

Looking longer term, when we announced our settlement with Apple, we indicated the deal would add an incremental \$2 of EPS from the combination of ongoing Apple licensing revenues and product shipments as we fully ramp. The \$2 EPS estimate excludes any impacts from the \$4.5 billion to \$4.7 billion of revenues resulting from the settlement and it does not incorporate any impacts from the reduction of excess litigation expense. The \$2 estimate also does not reflect any contributions from potential resolution with Huawei.

Before I finish my prepared remarks, let me summarize the key drivers of our long-term earnings growth opportunities. First, with the global launch of 5G starting in the second half of calendar 2019, we expect to see an increase in both device and chipset selling prices and are well-positioned given the strength of our 5G chipset roadmap.

Second, with the multi-year agreement with Apple, we expect to see significant revenue and margin expansion for both our licensing and chipset businesses, with further additional opportunities to capture broader product content over time.

Third, we are seeing increased design win traction for our RF front-end products across all OEMs, driven by the upcoming launches of sub-6 and millimeter-wave 5G devices.

Fourth, while some of our adjacent opportunities have seen short-term impacts from economic weakness, we remain confident in our ability to scale these opportunities over the next few years.

And lastly, we will continue to focus on increasing gross margins and driving operating expense efficiencies, as we realize our growth opportunities outlined above.

Thank you. I will now turn the call back over to Mauricio.

Mauricio Lopez-Hodoyan

Vice President, Investor Relations, QUALCOMM, Inc.

Thank you, Dave. Operator, we are now ready for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from the line of Mike Walkley with Canaccord Genuity. Please proceed with your question.

T. Michael Walkley

Analyst, Canaccord Genuity LLC

Q

Great. Thank you. Congratulations on the Apple settlement. A couple questions built into that. With the settlement reached with Apple, can you update us on how negotiations are going with Huawei? And with the Apple settlement, does the agreement the way it's structured with Apple trigger any changes to current licensees, or open up any other current licensee agreements? Thank you.

Alexander H. Rogers

Executive Vice President & President, Qualcomm Technology Licensing, QUALCOMM, Inc.

A

So, Mike, this is Alex. In terms of the negotiations with Huawei, they're ongoing. We feel that the Apple resolution enhances our ability to resolve issues with Huawei. So we think that's a good thing. In terms of the triggers, I can't get into the specifics of MFN type provisions. Those are confidential. But we're confident that we'll be able to address any inquiries coming in relating to the nature of the Apple resolution and essentially address other licensees. And I think if you take a look at our Q3 guide and our fiscal year 2021 incremental \$2 EPS gives you a sense of kind of how we see that all working out.

T. Michael Walkley
Analyst, Canaccord Genuity LLC

Q

Thank you.

Operator: Thank you. The next question is from the line of James Faucette with Morgan Stanley. Please proceed with your question.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you very much. I wanted to ask as it relates to just handset demand. Clearly, you're making adjustments and that has impact on QCT. But from a demand perspective, are you seeing any sequential changes or stabilization in that? Just trying to get a sense for where you feel like we're at in terms of potential incremental risk to those estimates.

And then dovetailing on Mike's question related to Huawei. Can you walk us through a little bit, maybe on a year-over-year basis, how Huawei's share gains and those kinds of things may be limiting QTL's benefit, particularly post the Apple settlement? Thank you.

Cristiano R. Amon
President, QUALCOMM, Inc.

A

Hi, James, this is Cristiano. I'm just going to get the first question and hand over to Alex. I'll start with the sequential. No, actually, if you look at our non-Apple MSM business, I think our growth has been consistent with sequential growth historically, when you look at our guide for Q3. So I think sequentially, we've basically seen the business behave in exactly the same way. What we did see, it was a little bit of a market weakness. I think it was in the script, economic weakness, particularly in China.

But the offset of that, we see a pause ahead of a 5G launch. And I want to remind everyone that China just launched. They were supposed to launch in September. China Unicom and then followed by Telecom just launched weeks ago and I think that has an impact, but if anything, builds our confidence I would think about the later part of the year with the 5G transition. With that, Alex, do you want to take the other question?

David E. Wise
Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Actually I'll jump in. This is Dave. On the Huawei share, couple of thoughts. One, obviously as they pick up a little bit of share right now, we are only being paid in QTL under an interim agreement which is fixed at about \$150 million a quarter. So, we don't see any financial pickup from share shifts that way. And then similarly in QCT, some of that share coming from OEMs that we monetize a little bit more.

Alexander H. Rogers
Executive Vice President & President, Qualcomm Technology Licensing, QUALCOMM, Inc.

A

I'll just add one more point. This is Alex. And that is, while we have this interim agreement arrangement, I just want to remind people what we do have an existing agreement with Huawei that was entered into at the end of 2014 on the eve of the NDRC resolution. We think that's very good, very fair agreement. And so, that is the context in which this ongoing negotiation is occurring.

Operator: Thank you. Our next question is from the line of Chris Caso with Raymond James. Please proceed with your question.

Chris Caso

Analyst, Raymond James & Associates, Inc.

Q

Yes, thank you. I guess the question is just helping us to get a little more granularity on what's in the \$2 number that you mentioned. I guess first thing on that is the timing of that \$2 impact. Obviously, as some of the chipset designs ramp that happens over time, so does the \$2 impact represent the full impact of that or perhaps some interim? In addition, does the current QTL guidance fully reflect the full royalty payments paid by Apple now such that we should be able to annualize that, and that will get us to the licensing portion of the \$2?

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yeah, this is Dave again. So, first of all, on that second part of the question, so our Q3 guide reflects the inclusion of Apple go-forward royalties. It does also reflect some headwinds related to the market. But it can give you a sense of the Apple contribution and where we are on a go-forward basis in QTL.

I would think about the quarter as it's a seasonally one of our lighter quarters for QTL. So if you think about annualizing that, I would take that into consideration as you think about the number on an annual basis.

And then, the \$2. So the \$2 – we've indicated the \$2 is reflective of contribution from ongoing licensing now going forward as well as chipset contributions once we ramp. We expect that as we ramp to see a more significant contribution on the QCT side.

So I think if you kind of look at where we see the contribution from Apple on the QTL side, based on our quarterly guidance, you can get a sense of that element of the \$2; and then, the rest is coming from QCT as we ramp. And I think as Steve said, we would see, there's potential for opportunities to do more with Apple down the road, but it's reflective of our views at this point.

Operator: Thank you. Our next question is from the line of Stacy Rasgon with Bernstein Research. Please proceed with your question.

Stacy Aaron Rasgon

Analyst, Sanford C. Bernstein & Co. LLC

Q

Hi, guys. Thanks for taking my question. I had a question on the QTL revenue run rate. So the revenue guide is \$1.275 billion, obviously includes Apple, also includes \$150 million in Huawei. If I take Huawei out, you're sort of guiding \$1.125 billion. Before you had told us the right run rate was kind of \$1 billion to \$1.1 billion. So even with Apple you're only guiding a little bit above that.

Is this just purely a function of the ongoing market weakness? Because I mean you've been running that core business \$900 million or lower the last quarter or two. Or is there something else going on? Like, what do you think the actual run rate of that core QTL is ex Apple and Huawei versus the \$1 billion to \$1.1 billion guidance that you had given us previously?

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yes. The \$1 billion to \$1.1 billion we had given previously was inclusive of the \$150 million with Huawei.

Stacy Aaron Rasgon

Analyst, Sanford C. Bernstein & Co. LLC

No, no. No, it wasn't. No, it wasn't.

Q

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

So two quarters ago, we had guided where it did not have it in. And then we adjusted that in the January call to be inclusive of the \$150 million from Huawei. And in the January call, we guided down the market by 50 million units. And in this call, we're also guiding down another 50 million units. So the bulk of what we're seeing – we are seeing some continued headwinds in the market for QTL in our Q3 guide which is somewhat offsetting the impacts of the addition of Apple.

A

Operator: Thank you. Our next question is from the line of Blayne Curtis with Barclays. Please proceed with your question.

Blayne Curtis

Analyst, Barclays Capital, Inc.

Hey guys. Thanks for taking my question. Wanted to ask on just the legal front what's left? You talked about reinvesting some of the potential savings and litigation costs. And maybe you can just level set us as to what that number was and then just walk through what's left. And if you can speak about the FTC, I would appreciate that as well. But kind of just walk us through the rest of the year as to what you have left in legal and so we can get an idea of what you're reinvesting? Thanks.

Q

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

Yeah. So litigation, said in the prepared remarks, Q3, we're not expecting to see a lot of savings, some modest savings in Q3. We had a heavy run rate on litigation in advance of reaching a settlement with Apple ahead of the San Diego case. And then, in Q4, we are expecting additional savings as we wind off of the Apple-related litigation expense.

A

A couple of offsets to that, namely the adjustment to our employee bonus accrual which had a big impact. It was, as I said, about 6 points of our 6% to 8% increase was related to that adjustment in the employee bonus and we have some of that flowing through into Q4 as well. So we're not expecting to see a lot of overall savings with the ramp down of litigation and some of that offset in Q3 and Q4, but we expect to see more of those savings flowing into fiscal 2020.

Donald J. Rosenberg

Executive Vice President, General Counsel and Corporate Secretary, QUALCOMM, Inc.

And, Wayne (sic) [Blayne], this is Don Rosenberg. Picking up on Dave's points about litigation, clearly we were spending a lot of money and a lot of time in resources on the worldwide litigation with Apple. As you know it's grown dramatically. So eliminating all of that now is pretty much the, has been the key to getting us back in a normal litigation cadence. We still have, obviously are waiting for the judge to rule on the FTC case, which we won't comment on. And we've got the normal amount of various patent cases and others around the world, but a couple of class actions that flowed from some of the previous allegations that are waiting to – Apple on the FTC and others. But it's a dramatic decrease in the amount of litigation we're going to have to be managing over the next several years, I think.

A

Blayne Curtis

Analyst, Barclays Capital, Inc.

Q

Thanks.

Operator: Thank you. The next question is from the line of Samik Chatterjee with J.P. Morgan. Please proceed with your question.

Samik Chatterjee

Analyst, JPMorgan Securities LLC

Q

Hey, thanks for taking the question. Steve, I just wanted to check if you can lay out for us the competitive landscape in 5G, particularly as it relates to baseband modem, software, Intel tech set like, does that change how you think about your position in 5G and the peak either the pricing or the margin opportunity around peer-to-peer content in 5G?

Additionally just a follow-up. I know you guys talked about the one-time payment from Apple. Any color on what the uses of that cash are in terms of how you're thinking about capital allocation around that, that will be helpful. Thank you.

Steven M. Mollenkopf

Chief Executive Officer & Director, QUALCOMM, Inc.

A

Hi, it's Steve. Maybe I'll ask Cristiano to take the first part of that and then I'll add my perspective and answer the second part.

Cristiano R. Amon

President, QUALCOMM, Inc.

A

Samik, we feel very strong about our 5G position in the marketplace. I think, I remind you all that we actually accelerated a timeline by one year and we've been the silicon of choice in every single trial in development across infrastructure in operator and device. So it's a very strong position consistent to what we saw the company doing in 3G and 4G. And we expect that's going to be a significant opportunity to expand ASPs in silicon content for QCT. And we just updated a number of designs, we see about 75 designs for 5G right now. And we also have that in all those 5G designs I think the absolute majority of it has our RF front-end content. So 5G is a very good story for QCT and will be a very material event in fiscal 2020.

Steven M. Mollenkopf

Chief Executive Officer & Director, QUALCOMM, Inc.

A

Yeah, I would just add very briefly that I think it's unfolded in a way that's pretty similar to the way in which we thought. It's very important to be at the front end of these transitions. Right now the team, and the front end of this transition really meant you had to have a lot of modem expertise across multiple technologies. But also our expertise to really handle all the RF bands and the complicated antennas, which is I think we're getting good traction on those investments in the past, and we're hoping to see that really flow into the business particularly in the next fiscal year.

Now the real race is, how do you bring 5G down in price point through integrated products. You saw the first one of our products announced. You'll see more and more of that. Very pleased with the way those products are being – demand or at least the roadmap traction that we're getting from those and we'll continue to do that.

In terms of the use of the one-time payment. I think we gave some data here about how our capital return program, particularly the ASR has done, which has been good. That's been a strong program for us. We are, I think, in a different mode in terms of our ability to look at the landscape here over the next couple years. The thing that the – really the Apple settlement and the launch of 5G coming together, we think it puts us in a very stable position in terms of our visibility into revenue and kind of the competitive dynamics.

So now the question is, how do we add to the company, what do we need to do in order to really drive some of the opportunities that we're getting from 5G. So we're looking at that, but still committed to all of the operational excellence, both cost and capital return that we talked about. But we got a lot of opportunity ahead, we think, particularly with the stability that this resolution provides us.

Samik Chatterjee

Analyst, JPMorgan Securities LLC

Q

Yeah. Okay. Thanks. Thanks for the color. Thank you.

Operator: Thank you. Our next question is from the line of Tal Liani with Bank of America Merrill Lynch. Please proceed with your question.

Tal Liani

Analyst, Bank of America Merrill Lynch

Q

Hi, guys. The \$4 billion, \$4.5 billion to \$4.7 billion for Apple, is all of it a retroactive payment for what they didn't pay? Or is some of it going to be related to future, kind of upfront payment for future? And that means how will you recognize revenues for this amount? Will it all be recognized as one-time? Or will you recognize some of it ratable over the life of the contract?

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yeah, the \$4.5 billion to \$4.7 billion is all for resolution of things prior to the effective date of the agreement. So it's all past. We'll recognize it one time as revenue in Q3 in our GAAP results. And then our go-forward guidance on QTL includes the forward impact of ongoing royalties from Apple starting in Q3. And I would note, our \$2 estimate is solely go-forward licensing revenues plus chip contribution.

Tal Liani

Analyst, Bank of America Merrill Lynch

Q

The question is – so that means you're going to recognize the \$4.5 billion to \$4.7 billion, you're going to recognize one time? Or you've already recognized it on a GAAP basis?

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yeah. It will be in Q3. Yes.

Tal Liani

Analyst, Bank of America Merrill Lynch

Q

It will be all in Q3.

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

We'll recognize one time in Q3.

A

Tal Liani

Analyst, Bank of America Merrill Lynch

Got it. Okay. Okay. Thank you.

Q

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

Yes.

A

Operator: Thank you. The next question is from the line of Ross Seymore with Deutsche Bank. Please proceed with your question.

Ross Seymore

Analyst, Deutsche Bank Securities, Inc.

Hi, guys. Congrats on the settlement with Apple. Just had a question on the revenue premise. I believe you guided for it to be up substantially and it was. And I think you said it was in line with your guidance. So two parts to the question. Can you give us a little color what drove that up so nicely in the March quarter? And then of equal importance, it looks like you're guiding for that to be flat sequentially in the June quarter. So can you talk about some of the puts and takes that benefited margin and why those are continuing or not in the June quarter?

Q

Cristiano R. Amon

President, QUALCOMM, Inc.

Hi, Ross. This is Cristiano. Yes. I think when we look at the March quarter, I think of product mix and especially I think of some of the premium tier chipsets was in seasonality with our Chinese customers. And as we look at the guide for Q3, those are some of the comments we made before. We had overall market weakness in China, but we are also seeing in the premium tier a pause as 5G has launched. 5G has launched in China. And it is an Android ecosystem phenomena, 5G launching on Android and where I see the MSM 800, which is our 5G designs, we see that pause as the 5G phones are coming to market.

A

Also consistent when some of the other OEMs that report their earnings and they talk about dynamics on the premium tier in the market. So, we're seeing that. I think the other comment we made is when you look at sequentially, our growth sequentially, when you look at our guide Q2 to Q3 for our non-Apple business when you eliminate the legacy Apple units, it's been very consistent and it's in line with the historical data.

Ross Seymore

Analyst, Deutsche Bank Securities, Inc.

Thank you.

Q

Operator: Thank you. Our next question is from the line of Matt Ramsay with Cowen & Company. Please proceed with your question.

Matthew D. Ramsay
Analyst, Cowen & Co. LLC

Q

Thank you very much. Good afternoon. Steve, you gave I thought some helpful information in your prepared script about some of the non-Apple progress that you made in QCT over the last couple of years. And you've dropped us some data in the last few quarters about some adjacencies that have been growing. I wonder if you might step back and give us a little color on the investments that you've been making in areas like auto, networking, some of the adjacencies that you had talked about growing the company into over the last maybe three or four years ago before some of the headwinds with Apple.

And Cristiano, specifically about RF, it looks like a ton of RF attach in the early 5G programs. Any thoughts about how sustainable that might be until volume ramps in 2020? Thank you.

Steven M. Mollenkopf
Chief Executive Officer & Director, QUALCOMM, Inc.

A

Why don't I start with the general one and, Cristiano, you can dig into the second one. So, if I look at the adjacencies, and we've done a couple of things here over the last several years. First of all, we've really tried to focus the company on things that we can see that heavily leverage the technology roadmap that we have for mobile.

We're doing that upstream of 5G primarily because we think that technology roadmap is the relevant roadmap in these adjacent industries. So, a great example of that is cars. So, in the car, the connected car, the opportunity for us to sell modems and now computing capability in the head units and then ultimately some of the broader computing in the car increases and we've seen that progress well here over the last several years. That's a good business. Longer timelines, harder to get into, harder but stickier, I guess, which is good. I think that's going well.

Industrial IoT, which is a business that I think leverages this digital transformation aspect that I mentioned in my remarks is going well. Consumer IoT I think has yet to really embrace some of the opportunities that are coming. We still think that's going to be an interesting opportunity, but the industrial side is probably a little better for us. We are continuing to invest in the go-to-market aspects. We have a pretty strong technology roadmap. It's our ability, is how do we mesh into those differentiate shaped markets versus what we see in cellular, but a very strong roadmap to go into there.

You mentioned the RF side. We think there's significant opportunity, particularly with the advent or the growth of 5G and the importance of the RF there, to grow content within the device. And when we see opportunities to do that, we're doing that. So, you see that in RF, Cristiano will comment about that.

I also don't want you to miss some of the opportunities like fingerprint that we've been able to invest into. And those are interesting opportunities. So, we see 5G as an opportunity to allow us to really leverage some of the R&D scale that we have in mobile. And as we see that, we're going to take advantage of it and try to stay focused along the same way.

Cristiano R. Amon
President, QUALCOMM, Inc.

A

So, I was just going to add a few things. First, when you look at, as you mentioned, the adjacent for us non-Apple, when you exclude Apple, even with some of the economic weakness we're seeing, we're still growing both Q2 and Q3. When we look at year-over-year, it's still double-digit growth. Some of those bets, they're small, but the trends are very – they are very good.

I think I want to highlight a few that Steve mentioned on industrial. The alignment on our industrial bet with the 5G and the fact that 5G is going to go to many other industries beyond mobile. It's going to be a major tailwind to get a scale on industrial IoT. We see the same thing with the Cellular V2X, and it was going to be added to our existing digital cockpit in telematics business.

One data point that we didn't mention, we still haven't bet on computing. And you should expect to see in the second half calendar, our 8cx which our first a Snapdragon dedicated for PCs with Microsoft. And that will be the first opportunity that we started to see that investment materializing.

Now going back to the front end, I believe that our position in 5G is differentiated. What's happening with 5G, the speed of the road map, especially as you think of a number of antennas and carrier aggregation is moving faster than we saw with 4G. And the ability to design as a system and claim some of the real estate that you had on devices for the front end is giving us an advantage.

We're the only company now that actually has everything from digital to the antenna in-house, and that give us an ability to build on our strength of being a system versus just a component provider. And that materialize in the fact that every single 5G design right now you'll find our front end and we expect that to continue.

Operator: Thank you. Our next question is from the line of C.J. Muse with Evercore ISI. Please proceed with your question.

Christopher J. Muse

Analyst, Evercore Group LLC

Q

Yeah, good afternoon. Thank you for taking my question. I'll ask two, if I could. First one, trying to level set QTL revenues ex-Apple. So could you help me understand what catch-up payments or input/output were related to ASC 606 and other kind of moving parts within that QTL for March and any expectations for June?

And then the second question, your goal I believe was \$6.4 billion OpEx without excess litigation for fiscal 2019. Obviously, will come in above that because of the litigation. But as you look to fiscal 2020, is that a number that we could get to considering that most of the litigation that we've been talking about is behind us now? Thank you.

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yes, so let me start with Q2. So we indicated in the prepared comments there was about \$100 million of more than expected one-time or out-of-period in the QTL revenues of \$1.12 billion. So that relates to I would say both ASC 606 adjustments for prior, as well as some one-time adjustments related to some cleanup from prior periods on a few programs.

And then, on a go-forward basis, our basis obviously with ASC 606 is forecasting our revenues. There is always going to be some chance of true-up as we move forward and move from really actuals that are based on somewhat of an estimate to sort of final understanding of how quarters rolled out. So Q3, nothing specific with respect to out of period. But we'll have some of that I think every quarter just based on the nature of ASC 606.

Then with respect to the OpEx, so, yeah, the target was to get to \$6.4 billion. We do still have excess litigation. And as I said before, we expect to rely some of those litigation savings as we move into fiscal 2020, maybe somewhat offset by our need to invest a little bit more to support ramp of Apple.

Operator: Thank you. Our next question is from the line of Kevin Cassidy with Stifel. Please proceed with your question.

Kevin Edward Cassidy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks for taking my question. For your chipset ramp with Apple, is there an opportunity to win back the sockets on 4G?

Cristiano R. Amon
President, QUALCOMM, Inc.

A

Hi, this is Cristiano. Look, we're not providing a lot of details. But I think it's fair to assume that it's going to be a new engagement. It takes a little bit of time to develop devices with the chipset. And independent of our engagement of Apple, in general, I think all developed economies will have 5G launch in 2019.

Kevin Edward Cassidy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay, great. And the RF front-end, you're saying the majority of those designs will include your RF front-end. Can you give us an idea of what percentage increase of content that might be?

Cristiano R. Amon
President, QUALCOMM, Inc.

A

Yeah, my comment is about the Android ecosystem. I think we're not detailing any RF front-end engagement with Apple right now. What I'll say as we reestablish ourselves as a supplier of Apple, we've reopened the door for opportunities beyond the modem.

Kevin Edward Cassidy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay, great. Thank you.

Operator: Thank you. Our next question is from the line of Timothy Arcuri with UBS. Please proceed with your question.

Timothy Arcuri
Analyst, UBS Securities LLC

Q

Thanks. Steve, so I wanted to go back to this \$2 number. The QTL piece is clear. You were clear about a six-year agreement with them. But on the QCT side, obviously, they have a pretty big modem team. So what supply agreement if any is there on the QCT side? I think you said multiyear when you announced that \$2 number. So should we just infer that you'll be the supplier to them for 2020 and 2021 and then beyond that who knows? Or is there something else to think about there? Thanks.

Steven M. Mollenkopf
Chief Executive Officer & Director, QUALCOMM, Inc.

A

Yeah. I'd say this may be a little bit unsatisfying, but I'm not going to go through all the details other than to say on the chipset agreement, it's a multiyear agreement. I think both companies are happy with it. It's something that at

least the way we look at it from the QCT side or from the QUALCOMM side, is it provides a lot of stability to our business. So we think that's a good agreement for us.

And it also, I'll just remind you, there's a lot of tension removed out of the system as a result of these settlements. And I really like the opportunity to have the two teams just working together on products in the future, much more natural relationships, something that I think both sides can find and maintain a good relationship. But it is a multi-year agreement. And other than that, I really can't talk much about it. You know the terms on a licensing agreement, six years plus an option to extend two more years for Apple.

Timothy Arcuri

Analyst, UBS Securities LLC

Q

Okay, Steve. Thank you so much.

Operator: Thank you. Our next question is from the line of Srinu Pajjuri with Macquarie. Please proceed with your question.

Srinu Pajjuri

Analyst, Macquarie Capital (USA), Inc.

Q

Thank you. Steve, just to follow up on the previous question to the extent you can tell us, what sort of ASP increase do you expect in 5G for the thin modems? And then, I'm guessing the \$2 number has some market share assumptions at Apple. To the extent you can tell us, is it 100% or is it less than that, at least for the first generation? And then, Dave, on the QTL EBIT margin, your guidance is for 65% to 69%. When do you expect to get back to the previous 80%, 85% ranges? Thank you.

Steven M. Mollenkopf

Chief Executive Officer & Director, QUALCOMM, Inc.

A

Okay. On the product assumptions with Apple, I won't give share numbers, but I will comment on ASP. The ASP story, at least in the case of as we move to 5G, they tend to be good for us. And the ASPs, as we're moving in through the 5G ramp, we've said that they're going to be a good story. And looking at what we're seeing broadly across the industry, that seems to be playing forward.

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

And two things will drive the QTL margin going forward. One will be some of the wind down of litigation, excess litigation spend. The other important one will be top line expansion, as we now add Apple back in and when we resolve Huawei, both of those will be factors driving margin up over time.

Operator: Thank you. Our next question is from the line of Brett Simpson with Arete Research. Please proceed with your question.

Brett Simpson

Analyst, Arete Research Services LLP

Q

Yeah. Thanks very much. Just a quick question on the corporate overhead you're assuming for the June quarter. I guess, when we look at the midpoint of your margin guide for QTL and QCT, there's about a \$300 million corporate overhead. Can you maybe just go into detail as to how that's built up, please? Thank you.

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yeah. That's the bonus adjustment that I talked about in my script. So resolution of Apple, we adjust our normal employee bonus accrual for the addition of the impacts of Apple. Because it's third quarter now, we take a number of quarters of catch-up into the quarter. That is not pushed out into the business unit margins. It's held in corporate. So that's the bulk of the delta you're seeing.

Brett Simpson

Analyst, Arete Research Services LLP

Q

And so, just to understand the movement in OpEx that we can expect through into the end of the fiscal year, you talked about the litigation. Can you size it at all for us? Can you help us understand, like the magnitude of how this sort of plays out over the next few quarters and how you see the underlying OpEx rising, and how we should really model the next sort of two or three quarters of absolute OpEx? Thanks.

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Sure. So first of all, in Q3, I think the midpoint of our range is around \$1.7 billion, \$1.8 billion, or something like that of OpEx. That includes, when you look at this bonus adjustment, it's about \$100 million. So it would put us at about \$1.6 billion, \$1.7 billion. That's up slightly from where we were in Q2 on a couple seasonal type things and includes some modest savings in litigation. In Q4, we expect further savings in litigation. The one-time elements of the bonus catch-up will be out and we think that it puts us probably somewhere flattish on the adjusted Q3. So, you think about Q3 without the \$100 million at \$1.6 billion, \$1.6 billion, \$1.7 billion.

Brett Simpson

Analyst, Arete Research Services LLP

Q

Okay, that's really helpful. And maybe just finally on op margin targets for QTL, now you've settled with Apple. I mean obviously there's still a Huawei settlement at some point, hopefully, fairly soon. But can you give us a sense as to how you think QTL op margins are going to trend beyond the June quarter?

And is there a path to get back to the sort of op margins that you were used to before a lot of these overhangs? I think you were sort of delivering something around about the 80% op margin level for QTL. Do we ever get back to those type of levels? And maybe for QCT, Cristiano, now that you're seeing a little op leverage from winning a big 5G deal with Apple, how do we think about op margin target for QCT longer term? Thank you.

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yes. So QTL, I think as I said before, I think a couple of drivers that will improve and that is the reduction of litigation savings. So, I said that we'd see more of that flowing into fiscal 2020 from a timing standpoint. And then resolution of Huawei and the addition of more on the top line in QTL. So obviously, that timing would be reflective of whenever we reach agreement with them as I think the two major drivers.

Cristiano R. Amon

President, QUALCOMM, Inc.

A

This is Cristiano. Just on QCT, I think the plan remains unchanged as we gain scale, continue to grow in mobile. And we have made a lot of progress growing our non-Apple business and then I think as all of the agreements get

in place, we expect to get back to our long-term profitability targets at QCT and we're looking forward to having a 5G Christmas as the year ends.

Brett Simpson

Analyst, Arete Research Services LLP

Q

Okay. Thanks very much.

Operator: Thank you. Our next question is from the line of Vijay Rakesh with Mizuho Securities. Please proceed with your question.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Q

Yeah, hi guys. Just wondering if you could give some more color on the RF front-end wins that you mentioned. I think you said 75 design wins and majority of them have a front end. Are you doing more of the mid end or low end or, and just if you could kind of ballpark what content we are looking at. Thanks.

Cristiano R. Amon

President, QUALCOMM, Inc.

A

Very good. Thanks for your question. On the 5G, if you look at all the 5G bands, the sub-6 bands as well as millimeter-wave, that's where you'll find our RF front-end content in all of those 75 design wins for 5G Android. The majority of them are flagship smartphones in the premium tier. And our content goes from the envelope trackers to the pairments, which is the PA modules, feature-rich content across all bands, switches and antenna tuners. And we, as I said before, I think we have been seeing significant differentiations in performance from 5G which had allow us to have a whole solution from the digital baseband all the way to the antenna.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Q

Got it. And on the QTL side, if you look at the June quarter, you talked about seasonality. But as you look beyond the Apple payments, trying to normalize what would be a normalized QTL run rate that we should be looking at? Thanks.

David E. Wise

Interim Chief Financial Officer, Treasurer & Senior Vice President, QUALCOMM, Inc.

A

Yeah, I think the best way to look at that is, the guide we have now in Q2 includes Apple on a go-forward basis. It includes some headwinds associated with market weakness. And it's one of our seasonally lighter quarters for QTL. So I think if you sort of take those factors into consideration, it'll help you triangulate to sort of how to think about it on an annualized basis.

Operator: Thank you. That concludes today's question-and-answer session. Mr. Mollenkopf, do you have anything further to add before adjourning the call?

Steven M. Mollenkopf

Chief Executive Officer & Director, QUALCOMM, Inc.

Yes. First of all thanks everyone for joining us today. Just a quick note to our employee base, just thank you so much for staying focused during this period of time. You put the company in a great position. I look forward to the

ramp of 5G and really the opportunities that are ahead of us. Just thanks a lot for all your hard work and we'll talk to you next quarter.

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

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