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BlackBerry Ltd. (BB)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the BlackBerry Fiscal Year 2019 Second Quarter Results Conference Call. My name is Lisa, and I'll be your conference moderator for today's call. During the presentation, all participants will be in a listen-only mode. We will be facilitating a brief question-and-answer session towards the end of the conference.

Should you need assistance during the call please signal a conference specialist by pressing star zero. As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to our host for today's call, Christopher Lee, Vice President of Finance. Please go ahead.

Christopher T. Lee
Vice President-Finance, BlackBerry Ltd.

Thank you, Lisa. Welcome to the BlackBerry fiscal year 2019 second quarter results conference call. With me on the call today are Executive Chairman and Chief Executive Officer, John Chen; and Chief Financial Officer and Chief Operating Officer, Steve Capelli. After I read our cautionary note regarding forward-looking statements, John will provide a business update, and Steve will then review the financial results. We will then open the call for a brief Q&A session.

This call is available to the general public via call-in numbers and via webcast in the investor information section at BlackBerry.com. A replay will also be available on the BlackBerry.com website. Some of the statements we'll

be making today constitute forward-looking statements and are made pursuant to the Safe Harbor provisions of applicable U.S. and Canadian securities laws.

We'll indicate forward-looking statements by using words such as expect, will, should, model, intend, believe, and similar expressions. Forward-looking statements are based on estimates and assumptions made by the company in light of its experience and its perception of historical trends, current conditions, and expected future developments, as well as other factors that the company believes are relevant.

Many factors could cause the company's actual results or performance to differ materially from those expressed or implied by the forward-looking statements, including the risk factors that are discussed in the company's Annual Information Form, which is included in our Annual Report on Form 40-F and in our MD&A. You should not place undue reliance on the company's forward-looking statements.

The company has no intention and undertakes no obligation to update or revise any forward-looking statements, except as required by law. As is customary during the call, John and Steve will reference non-GAAP numbers in their summary of our quarterly and annual results. For a reconciliation between our GAAP and non-GAAP numbers, please see the earnings press release and supplement published earlier today.

I will now turn the call over to John.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Thank you, Chris. Good morning, everybody. And, as Chris stated, I will reference non-GAAP numbers in my summary. In today's discussion, I will try to include more comments on BlackBerry's competitive edge in the software markets we play in. We are executing against our fiscal 2019 financial and operational plan. This quarter was a record high for total software and services billings. We see solid customer demand for our safety and security focused products, resulting in double-digit year-over-year software and services billings growth for the second consecutive quarter.

The business that has showed the best year-over-year momentum in the quarter was BlackBerry Technology Solutions, which reported its highest ever quarterly revenue. Additionally, our Enterprise Software business experienced sequential quarterly growth. I will provide more color on both of these later.

Let me provide some highlights for the quarter. Total revenue came in at \$214 million, total software and services revenue was \$197 million, gross margin was 78%, operating income was \$17 million, and operating margin was 8%, an increase of 2 percentage points from last quarter. EPS was \$0.04. Total ending cash and investments came in at \$2.4 billion.

Next, here are some of the significant highlights by businesses. In our BlackBerry Technology Solutions business, which include embedded software and asset tracking, BTS revenue increased 29% year-over-year, driven primarily by BlackBerry QNX. This is the third consecutive quarter of around 30% year-over-year revenue growth.

Software development licenses, services, and royalty revenue have all grown from the increase in the number of design wins. Revenue growth has been broad based across various different types of applications. Our infotainment system business grew year-over-year and our non-infotainment system business, such as ADAS, Advanced Driver Assistance Systems, and instrument clusters grew at an even faster rate year-over-year.

A notable design win in the quarter was for a next generation digital cockpit for a multi-national auto OEM through our Tier 1 partner Yangfeng Visteon, this probably gives you a hint that it is a Chinese company. The competitive edge of QNX is its highest safety certification, security capabilities, and reliability.

In addition to our design wins, the number of qualified worldwide channel partners for BlackBerry QNX increased to 48, which represents a 20% increase from the start of the fiscal year. In the quarter, we added new partners in China, Japan, South Korea, and the United States. As you may recall, we stated at the beginning of the fiscal year that one of the BlackBerry QNX business goals was to expand our sales channel, and the BTS team has done a good job to achieve that objective.

Moving on to BlackBerry Radar, our asset tracking business, we are making progress, adding new customers, receiving repeat orders, and growing our pipeline. Radar is differentiated from our competitors due to; number one, the high volume of collection, up to 100 times more data than other solutions in the market; two, it is designed for cloud-based – cloud-hosted business analytics applications, and reporting in one integrated and scalable platform; and finally, it has long lasting battery, its modular architecture, and the ease of installation.

Customers consistently cite the positive return on investment they obtain when they utilize BlackBerry Radar. The two main reasons are improved asset utilization and time savings that result in higher driver satisfaction. However, our revenue growth has been slower than expected, as we invested in partners and personnel to address the many opportunities we have. We believe the investment we have been and will be making will enable us to reach our goal of \$100 million in cumulative revenue over the next three years.

Next, I would like to spend a few minutes on the Licensing business. Our Licensing business performed well in the quarter, even against a pretty tough comparison to last year. I'd like to spend a couple of minutes to explain our licensing business, because it may not be as well-understood. Our licensing business actually comprises of two major parts. One is in technology licensing and the other one is in IP licensing. On the technology side, we provide our secure embedded handset operating system and related security software to OEMs and BlackBerry Messenger for consumers.

On the IP side, we have over 37,000 patents with an average life of 10 years, which is rather young. On an annual run-rate basis, our total licensing business currently is at least \$200 million in revenue. Of this amount, about \$60 to \$80 million currently relates to technology licensing and the remainder relates to IP licensing.

Currently, well over half of our total licensing revenue is recurring and our quarterly run-rate for total recurring license revenue is somewhere between \$40 to \$45 million. Our licensing business is a key component of our total software and services revenue mix, and we anticipate our licensing business to continue to grow steadily over time.

Now, I would like to spend a minute on the Enterprise Software business. We do have sequential double-digit billings growth, resulting in total Enterprise revenue increasing 11% from Q1 of 2019. As you recall from last quarter, more of our Enterprise revenue is recognized on a ratable basis under ASC 606. Concurrent with this accounting change, we modified our sales model and increased our focus to sell subscription licenses rather than perpetual licenses.

In the quarter, the Enterprise business experienced sequential growth in four areas, endpoint management, crisis communication software, secure communication software, and professional services. The reason we win is because we offer an integrated and scalable mobile-first solution that helps secure our customers' entire ecosystem and can be managed on a single platform. These results reinforce our position as one of the market share leaders.

IDC noted our number two share position in its Worldwide EMM Market Share 2017 Report published several months ago. That share position was unchanged from IDC's 2016 report. BlackBerry was also recognized for its innovation, as we were named as a leader in both the 2018 Gartner Unified Endpoint Management Magic Quadrant, as well as IDC's MarketScape.

We continue to build a stronger presence in various regulated industry segments. In financial services, we increased our market share through a combination of new logo wins, including a leading global investment bank headquartered in New York, and Absa Bank, a South African financial services provider, as well as expanding our product footprint within existing customers, such as Lloyds Bank in UK and KfW in Germany.

In government, our products are chosen by government agencies from countries around the world. I'd like to highlight several wins in the quarter. The U.S. Department of Justice chose BlackBerry's on-premise solution covering all their 150,000-plus employees and contractors.

[Technical Difficulty] (00:11:01-00:11:16)

Let me continue. The Department of Veterans Affairs chose BlackBerry's solution under a multi-year FedRAMP cloud license. FedRAMP cloud is growing very fast, faster than on-premise solutions, and we do offer both. With the win at the VA, the number of U.S. government agencies we have FedRAMP cloud authority to operate with increased to six and the number of BlackBerry FedRAMP cloud users doubled to about 1 million.

One of our European government customers also bought more of our secure voice solution, expanding our share with that nation. In Canada, we also expanded our footprint with repeat orders, and are helping the Canadian government monitor their entire mobility environment and detect issues before they impact a user base of about 100,000 people.

In the quarter, we also expanded our channel network by entering into a multi-year reseller agreement with AT&T. This agreement will offer BlackBerry's suite of secure enterprise software and services to AT&T's business customer base in the United States. The agreement provides BlackBerry an opportunity to take advantage of a vast customer base.

At our Analyst Day earlier this year, I announced our goal to utilize all our technology assets to create an end-to-end platform that would secure and manage the multitude of enterprise endpoints expected in the future Enterprise of Things. That's very long – a long sentence. On September 12, we took a major step towards achieving that goal with our announcement of BlackBerry Spark, which is an Enterprise of Things platform designed and built to address two very significant and intersecting global trends; one being the hyperconnectivity of things, and the other cybersecurity requirements.

BlackBerry has the technology and DNA to play in a very substantial market influenced by these trends. Per industry analysts, IoT endpoints will grow from a mid-single-digit billions install base in 2017 to potentially a 75 billion endpoint install base in 2025. Spending is estimated to be in the trillions of dollars. A substantial portion of this install base and related spend is expected to be enterprise endpoints.

Our customers and partners will be able to build and deploy new products and solutions with BlackBerry data security and privacy at the foundation. We believe this platform will afford BlackBerry compelling growth opportunities in the years to come. We're developing a number of vertical solutions, which will become available in September 2019, calendar year 2019 that is obviously.

I will now turn the call over to Steve to provide more details about our financial statement and our quarterly performance.

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

Thank you, John. My comments on our financial performance for the fiscal quarter will be in non-GAAP terms, unless specified otherwise. We delivered second quarter non-GAAP total company revenue of \$214 million and GAAP total company revenue of \$210 million. I will break down the revenue shortly.

Second quarter total company gross margin was 78%, up 2% from a year ago. Our non-GAAP gross margin includes software deferred revenue acquired but not recognized, of \$4 million and excludes stock compensation expense of \$1 million and restructuring expense of \$1 million.

Operating expenses of \$150 million were down 3% sequentially as we continue to maintain financial discipline by optimizing our resources, becoming more efficient and improving our bottom line. Our non-GAAP operating expenses exclude \$22 million in amortization of acquired intangibles, \$20 million in stock comp expense, \$2 million of restructuring charges, a benefit of \$2 million for acquisition and integration costs, and a benefit of \$70 million related to the fair value adjustment on the debentures.

Non-GAAP operating income was \$17 million and non-GAAP net income was \$21 million. Non-GAAP EPS was \$0.04 in the second quarter. Our adjusted EBITDA was \$33 million this quarter, excluding non-GAAP adjustments previously mentioned. This equates to adjusted EBITDA margin of 15%.

I will now provide a breakdown of our revenue in the quarter. Total software and services revenue was \$197 million, representing 92% of total revenue and up from 79% compared to a year ago. Total SAF revenue was \$12 million and total handset device revenue was \$5 million. SAF revenue continues to wind down as expected. Handset revenue resulted from the release of balance sheet credits, which had a small benefit to EPS.

I will now provide a further breakdown of our software and services revenue in the quarter. Enterprise software accounted for 47%, BlackBerry Technology Solutions accounted for 25%, and Licensing, IP, and Other accounted for 28%. Please refer to the supplemental table in the press release for the GAAP and non-GAAP details.

I would now like to make several comments to provide further clarity. As reported, Enterprise software revenue declined approximately 10% year-over-year. This is an improvement from the 18% year-over-year decline we reported last quarter. After implementing ASC 606 at the beginning of this fiscal year, I want to remind you that the revenue from the majority of our perpetual licenses is no longer recognized immediately. In general, revenue from perpetual licenses is now recognized ratably over a four-year period.

In FY18, perpetual licenses accounted for between 20% and 30% of Enterprise software revenue. If we were to account for the second quarter of last year in the same way as this fiscal quarter, then Enterprise software revenue would have experienced low single-digit growth.

While there are other factors contributing to this year-over-year comparison, it is clear that we have made progress in the Enterprise software business, as evidenced by 11% sequential revenue growth, double-digit billings growth, and deferred revenue growth. We anticipate the headwind from this accounting and sales model changes to impact Enterprise software revenue for the remainder of fiscal year 2019. We expect better year-over-year comparisons in fiscal 2020, as we lap the accounting and sales model changes.

Recurring software and services revenue was approximately 81% in the quarter, consistent with the definition we have previously used. As we mentioned last quarter, a primary benefit of recurring revenue is that it is more predictable. Therefore, if we include perpetual licenses that are now recognized ratably in the calculation, then recurring revenue would have been over 90% in both Q1 and Q2 of this year.

Now moving on to our balance sheet and working capital performance. Total cash, cash equivalents, and investments were \$2.4 billion, which increased by \$17 million from May 31, 2018. Our net cash position was \$1.7 billion at the end of the quarter.

Moving to the cash flow statement. Free cash flow, before considering the impact of restructuring and legal proceedings, was positive \$37 million. Cash generated in operations was \$31 million and capital expenditures were \$4 million.

That concludes my comments. I'll now turn the call back to John to provide our financial outlook.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Thank you, Steve. We have financial outlook before our Q&A. First, we reaffirm our fiscal year 2019 financial outlook, which has four highlights. One, the total company software and services billings growth to be double-digits; two, the total software and services revenue annual growth of between 8% to 10%; three, non-GAAP EPS to be positive; and finally, to deliver positive free cash flow before considering the impact of restructuring and legal proceedings. This, by the way, has been consistent from previous guidance.

Our annual guidance is based on the following premises; number one, BTS revenue to continue its double-digit growth throughout the year, although the growth may be closer to 20% rather than 30%, due to tougher compares in the next two fiscal quarters. Licensing revenue to perform better than we originally planned. Enterprise billing and revenue to continue its sequential growth for the remainder of 2019. For the full year, we anticipate Enterprise billings to be relatively flat year-over-year and Enterprise revenue to be down high single-digits to low double-digits year-over-year, because of ASC 606 implementation.

Similar to fiscal 2018, total software and services revenue to be weighted towards the fourth fiscal quarter. Recurring software and services revenue are expected to be in the low-to-mid 80% range in fiscal 2019, as Steve just outlined.

So I will now open the call for Q&A. Lisa, could you please administrate that?

QUESTION AND ANSWER SECTION

Operator: Thank you. And we will now begin the question-and-answer session. [Operator Instructions] We request that you limit yourself to one question and one follow-up. Our first question comes from the line of Daniel Chan from TD Securities. Your line is open.

Daniel Chan

Analyst, TD Securities, Inc.

Good morning, guys.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Good morning.

A

Daniel Chan

Analyst, TD Securities, Inc.

So the enterprise revenue was better than expected and billings continue to be strong. Thanks for the color on the year-over-year comparisons, given the different accounting rules. But just to simplify things, were there any perpetual license deals in this quarter that helped those numbers come in so strong?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Yeah, we have perpetual license. Most of them are taking over – ratably over the four years. And there are very limited of them who are taking upfront, because of the accounting rules that we are not allowed to take it over four years.

A

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

Yeah. We did have a very small number of perpetual license. I want to remind you that when we made this switch from ASC 606, Dan, you may recall that we said we were going to basically not offer perpetual licenses, only in rare cases, and those numbers were very small.

A

Daniel Chan

Analyst, TD Securities, Inc.

Okay. So just to summarize, the strength or the outperformance in ESS and the billings is primarily driven from subscription licenses?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Yes.

A

Daniel Chan

Analyst, TD Securities, Inc.

Okay.

Q

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

Perpetual licenses, which is the same.

A

Daniel Chan

Analyst, TD Securities, Inc.

Okay, great. And then switching gears to the IP licensing side, looks like Facebook just recently bought five of the six patents they're asserting against you. Is there any read-through from the timing of these purchases?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

We advise not to make any comments on an ongoing legal proceeding. You will have to make your own judgment on that.

A

Daniel Chan

Analyst, TD Securities, Inc.

All right. Thank you.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Thanks, Dan.

A

Operator: Our next question comes from the line of Mike Walkley from Cannaccord Genuity. Your line is open.

T. Michael Walkley

Analyst, Canaccord Genuity, Inc.

Great. Thank you.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Good morning.

A

T. Michael Walkley

Analyst, Canaccord Genuity, Inc.

Good morning. A question just on the Radar business. You shared that you expect it to reach \$100 million cumulative revenue over the next three years. Can you just talk about how you're seeing your channel development build out? Also, I believe three of your larger cargo tracking companies up for sale, so do you see opportunities in the competitive environment maybe to gain share with some customers potentially through sale? And then who do you see as your leading competitors? Thank you.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

I missed your last part, Mike, your last question.

T. Michael Walkley

Analyst, Canaccord Genuity, Inc.

Q

Just saying, who do you see as your leading competitors in the market currently?

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Okay. So, first of all, our \$100 million cumulative is for the next three years. We laid out an operational plan that does not include acquisitions of any sort in this area. I wouldn't say we're not open to it, but it's not a high priority item for us on acquisitions in this area. We believe that the product strength is there. We know it works well. The customers start rolling it out. We had some very good names and big names that are our customers taking advantage of it and they are gradually buying more.

Our win rates are quite high compared to the industry. I think we win about half of all the POC's (proof of concepts) that we complete. So the combination of that – we're quite encouraged with the competitiveness of our product. Again, it's because it was designed for the cloud, for the analytics, and now we are trying to tie that into our Spark platform, so that it could be managed by UEM and the security side. So there are a lot of good things there. At this point we don't believe we need any help inorganically.

T. Michael Walkley

Analyst, Canaccord Genuity, Inc.

Q

Right. Just a clarification, you're just investing to scale up your own sales channels and platforms, and that's where you're going to invest in that. And then with competitors potentially for sale, do you see any competitive dynamics that's helpful to BlackBerry in your win rate?

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

I don't know what area you're referring to. I'm mostly just focused on the reach, which is the channel – that is why we've been spending a lot of our time and energy on building out channels and getting these big resellers to resell our products. And again, from a product to product comparison, the fact that this is a modular design and the design that is, again, a more the modern architecture I would say, and the hardware is not really the important part. It's a relatively simple component, unlike competitors which are more proprietary based. So we have some built-in advantage because of that, but I'm not sure exactly which area you're referring to.

T. Michael Walkley

Analyst, Canaccord Genuity, Inc.

Q

Okay, great. Thanks for taking my questions.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Sure, absolutely, Mike.

Operator: Our next question comes from the line of Paul Steep from Scotia Capital. Your line is open.

Paul Steep

Analyst, Scotia Capital, Inc.

Hey, good morning. Hi.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Good morning.

A

Paul Steep

Analyst, Scotia Capital, Inc.

John, can you chat a little bit about with UEM and the EMM market, how you've seen your market share maybe progress over time? And what you view as sort of the health of the base? And then my quick follow-up, I guess, would be, to either you or Steve, in terms of the sales force transition, what the early response has been and how settled in people are with the new program. Thanks.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Okay. I think I'll take the first one then. We are very strong in – from a UEM side of the equation, we are very strong in two verticals, the financial and the government verticals and as we build more and more solutions that are geared towards cybersecurity and a platform for endpoint protection and management. So, we have a lot of opportunities there, especially in the government sectors and we've been in a lot of discussions on a lot of different projects.

A

We need to probably broaden ourself in channel reach to other verticals that are also being regulated. There are opportunities in transportation that ties to Radar and QNX. We think there are some encouraging opportunities there. There could be opportunities in the healthcare side of the equation. So we're not very big in the healthcare side, but it's something that a lot of the healthcare customers and prospects would like to work with us on. So I think we have expansion in verticals and also kind of moving up the stack on UEM with our existing customer base.customer base.

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

And I'll take the second part of your question, which is related to how is the sales force responding. And over the course of the year, there'll be continued improvement on the response. First, individual sales person, it's not until they have the opportunity of really closing the large deals do they see the emphasis on subscription model versus perpetual, so we'll be working through. But I think it's gone according to plan and we haven't had any surprises as a result.

A

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

I'd like to add something to that. From what I could gather, the sales force is not the problem, because our compensation doesn't differentiate whether you are – because we comp people on billings. So how we take revenue from an accounting point of view, it doesn't really affect them individually. Maybe the sales management team is a little different, but I believe that changing the customer's way of wanting to buy things may be a little bit

A

more challenging than my sales team. Customers especially in government tend to buy from a program – on a program basis, so they tend to want to acquire in a perpetual way.

Paul Steep

Analyst, Scotia Capital, Inc.

Thank you.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Sure.

A

Operator: Our next question comes from the line of Gus Papageorgiou from Macquarie. Your line is open.

Gus Papageorgiou

Analyst, Macquarie Capital Markets Canada Ltd.

Hi. Thanks for taking my question. Just want to focus on the IP licensing business. Couple of questions there just. Can you give us an idea as to sense of why that business is doing better than you expected? And secondly, obviously, you've been flexing your legal muscles, so going after some big players. I'm just wondering what are the prospects there of negotiating licenses versus one-time payments in the event that, I think, most companies that resist licenses and rather just cut you a check, how do you encourage them to take on a license versus just cutting a one-time check?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Do you want to take that?

A

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

Well, yeah, I can take that, Gus. Well, the first case is that we think it's doing better because, A, we have a better base of predictability. As we mentioned earlier, in the IP licensing as well as our other licensing within the category, we're running \$40 million to \$45 million. So, two factors will come into play. One is what you mentioned is getting more of a recurring revenue from our discussions around IP licensing. But the other one is one-time events. So there will be some – our expectation is that there will be some one-time events in the later half of this fiscal year. And respectful to the comment of how do you get people to have more of a recurring model rather than the one-time event, it just takes place in the negotiations through the volume and we have to be receptive to both models and we have been. Our preference naturally is more longer-term volume based.

A

Gus Papageorgiou

Analyst, Macquarie Capital Markets Canada Ltd.

And I assume that longer-term is when the negotiations are hospitable versus confrontational?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Well, okay, so, Gus, let me – you used the word legal muscle. Compared to some of the people we go after, we really don't have that much of a muscle. But I believe that our duty is to make sure that our investors get a

A

reasonable return on the investment made in maintaining and creating an IP portfolio of outsized and complexity and we continue adding IP innovation into it, it's a pretty costly proposition.

So, because of that, we believe that we need to go after companies that use our intellectual property and also offer it to companies that may be able to take advantage of our intellectual property. So it comes in all sizes and shapes. It comes in all types of reactions, some of them are very receptive, some really want to do this, some are little bit more withdrawn. We absolutely do not like to sue people. I think this is really a waste of time and waste of money, in my personal opinion.

But on the other hand, if people are just either ignoring us or not providing a reasonable resolution, then we have no other choice for our shareholders. We believe we need to do what's the minimum. So, therefore, we use the legal side very, very carefully and very limited, and we prefer to have a business solution rather than a legal solution.

So, now, regarding recurring versus perpetual, this is one – perpetual one-time meaning, sorry. This is one of those situations where people want to – obviously, want to pay only one-time, and then they just don't have to remember it anymore or deal with it anymore. And we, obviously, want the recurring and the tug of war is part of – like Steve said, it's part of the negotiation. And this is why sometimes it's so unpredictable whether it's this quarter or next quarter, and we won't just give up because of the quarterly boundary, and that's how we think about the business.

Gus Papageorgiou

Analyst, Macquarie Capital Markets Canada Ltd.

Q

Great. Thank you very much.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Sure, Gus.

Operator: Our next question comes from the line of Steven Fox from Cross Research. Your line is open.

Steven Fox

Analyst, Cross Research LLC

Q

Thanks. Good morning. Hi.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Good morning.

Steven Fox

Analyst, Cross Research LLC

Q

Good morning. I was wondering if, first of all, you could expand on one of the bullets in your slide, where you talked about building out your Jarvis sales team a little bit more in terms of we needed...[Technical Difficulties] (00:34:54).

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

You're breaking up.

A

Steven Fox

Analyst, Cross Research LLC

Oh, sorry.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

You broke up a little bit. You said about the Jarvis team?

A

Steven Fox

Analyst, Cross Research LLC

Yeah. So why are you – why is there a dedicated sales team being put in place? And can you give us some – an update on how that innovation is moving towards commercializing?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Oh, yeah, yeah. No, we don't really have a Jarvis sales team. Currently, we're offering Jarvis to the OEM and Tier 1 in the auto sector, and we're using the existing QNX team. So I don't think I have said that we're building a Jarvis sales team. Maybe in the future that might that need, but currently that's not in our plan.

A

Steven Fox

Analyst, Cross Research LLC

And then how close do you think you are to sort of seeing meaningful commercialization around Jarvis?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

We have one customer already and we have one that we believe will sign up very, very soon. These, obviously – when we talk about these customers, they are pretty big name customers that you will recognize. And this is really about getting more and more of the developer and the development process, the qualification process using it. As time progresses, we'll get more and more revenue out of it. And so, we have a commercial license. We are building refinement, next-generation upgrades, and stuff to it. So it's more engineering than sales.

A

Steven Fox

Analyst, Cross Research LLC

Got it. And then just on the quarter you just reported, can you give us some more color on QNX's mix? How successful you've been with the recent wins in revenues and moving out of the infotainment?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Oh, that's a good question. Actually, as I said earlier, our infotainment business grew year-over-year, but our non-infotainment business grew even much faster. We have some really strong wins in Advanced Driver Assist, as well as instrumentation cluster. And, obviously, we have ongoing business in over-the-air and hypervisor. So

A

things are looking – touch wood, things are looking pretty good and these design wins in the last couple of years finally starting to yield some result for us.

Steven Fox

Analyst, Cross Research LLC

Thank you very much.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Sure, absolutely.

A

Operator: Our next question comes from the line of Gabriela Borges from Goldman Sachs. Your line is open.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Hi. Good morning. Thank you for taking my question. I wanted to follow-up with Steve on earlier commentary on perpetual license mix being relatively small. Just wanted to reconcile that with the mix of recurring going down quarter-over-quarter to 81% from 86%. Could you just explain what the factors are driving that?

Q

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

Sure. The first thing is that the recurring is based on consistent methodology, which includes this total software and services less professional services, less IP licensing from a definition standpoint. But during the quarter we could have a mix difference, where under ASC 606, if we achieve all the performance obligations for our sale, then we have to take the revenue – which is the proper channel, we take the revenue in the immediate standpoint. So there are instances of that. One example could be our Secusmart software. Gabriela, you recall that what turns immediate revenue into more ratable revenue is a lot of cases, services that we have to continue to perform because of our NOC. So it's really the mix between the type of software that we're selling quarter-to-quarter.

A

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

That makes sense. And the follow-up is for John, if I may, on the QNX business. We talked a little bit about the longer-term design win pipeline. I'd appreciate it if you could also comment on your visibility into the second half of the year. How do you feel about that revenue ramp? And your comment on closer to 20% growth versus 30% growth, just wanted to confirm that's just because of the comps and nothing has changed internally with respect to your own expectations. Thank you.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Yeah. It's just a matter of the magnitude of the comp, the magnitude of the numbers, the base numbers that are coming. The good thing about the QNX business is it's quite predictable. And the bad thing is it took a while to make it predictable, because every time we win, we win a design win. You got the initial batch of development seats, licenses, things are now very vague, probably six – a lot of times it's about six figures numbers, hundreds of thousands, but that's pretty much a one-time thing. There might be some ongoing professional services to take the engineers for the Tier 1 or the OEM to use our platform.

A

And then once they start delivering the product, then we get a royalty check and it's rather steady in that sense. So it takes a while to get a steady stream of revenue. And what you are seeing – or we are all seeing right now this year is the wins that we have accumulated in the last few years starting to pay dividends, and they are starting to either step up the developments in some cases or they're shipping the product. And then, therefore, we're getting the ongoing. So we don't have any fundamental issues with the business. My comment of more 20% than 30% is because of the fact that the numbers are bigger in the second half of last year.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

Understood. I appreciate the color. Thank you.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Sure.

Operator: Our next question comes from the line of Todd Coupland from CIBC. Your line is open.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Hi, Todd.

Todd Coupland

Analyst, CIBC World Markets, Inc.

Q

Hey. Good morning, everyone.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Good morning.

Todd Coupland

Analyst, CIBC World Markets, Inc.

Q

I also had a QNX question. So I get the 20% in the second half of the year. Beyond the next couple of quarters, what does the pipeline for QNX look like? You had a string of wins that have built up this base that you're now benefiting from, but what is visibility in little bit longer-term pipeline for the next fiscal year? Thanks.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

We should continue to see growth. I don't have the numbers of exactly what percentage it might be, but I'm reasonably comfortable it's double-digit. So, another question is the double-digit with a one or a two or a three? But we feel it's pretty good. In general, I know folks had a concern about whether it's been growing at 29%, 30% in the first two quarters, and now we're going to say we're growing in the lower 20s. Again, it's certainly because of the numbers, the comps, and we have no issue in the business. The visibility is quite good. In fact, we have high hopes that this business continues to grow in the next couple of years in a reasonable fashion, because of the design win we have. And a lot of the design wins – the big design wins we have, some of them are starting to

yield results. But some of them are – whether we see Nvidia or Baidu and all that, they are yet to come. And so they will add to the growth in the future years.

Todd Coupland

Analyst, CIBC World Markets, Inc.

Q

Okay. And just on that point, it seems – you did call out ADAS, but it seems like it's still tilted towards infotainment and there's a lot of competition in the ADAS side of the business. Can you just give us an update on your views of your competitive position specifically for ADAS features? Thanks a lot.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Yeah. Every quarter we win some ADAS design. So I don't get the feeling from any of our people that ADAS is "very competitive." I'm sure that we don't win every opportunity out there, but we win [ph] a number of the (43:32) opportunity, don't seem to be a concern of that. Did you hear anything out there that I should be aware of?

Todd Coupland

Analyst, CIBC World Markets, Inc.

Q

Are you asking me or your staff?

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Yeah. No, no, I'm asking you. I haven't heard. You're the first person who asked me about whether our ADAS is competitive, because – again, not that because I'm an expert in this, it's just that every quarter we win some ADAS and we're in a number of conversations. I don't hear my sales force saying that the ADAS are overly competitive. Usually, it's a code word for that situation you're pointing out. But we know infotainment is competitive and infotainment pricing is competitive, probably because of the Auto Grade Linux, but we still win infotainment deal. The year-over-year revenue is still going up. So, ADAS actually has been growing pretty nicely. So I don't know why you – did you hear anything that I should be aware of?

Todd Coupland

Analyst, CIBC World Markets, Inc.

Q

No, it's just that there's a lot of people interested in that part of the vehicles disruption.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Oh, yeah.

Todd Coupland

Analyst, CIBC World Markets, Inc.

Q

And so it's never been clear to me that your market share and footprint has been firmly established there yet. So it's more along those lines and sort of specific wins with other players.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Oh, I see. No, we win some really big ADAS. I mean, I just told you that we won a big account in the past quarter. I want to add one thing to this. It's a good question. Why we win? We win because – every one of those solutions

we talk about, ADAS or clusters, OTA or safety, everything we win is because of the ISO safety certification that we have. And this is where Tier 1's want to work with us and OEM's want to work with us. And the reason is pretty simple. There's a bigger question. The bigger question is the trend of the OEM's and the Tier 1's are going to less of the high performance components, the computer, HPC or people call it ECM, different people call it different names. The idea is, there are a number of computers in the car, whether it's the connected cars or autonomous driven platform. So, if you get less number – more integrated and less number of HPCs, the safety of each of the HPCs becomes more important. ADAS is part of that. And so we win because of that. And currently we're the only – ISO certification standard, a higher standard in safety, we're the only provider of that. So this is why everybody wants to work with us. I don't want to be overly bullish about it and say we win every deal and stuff, but any safety-oriented component, we have a very high chance of winning.

Todd Coupland

Analyst, CIBC World Markets, Inc.

Okay. That's great, John. Appreciate the color.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Sure.

A

Operator: Our final question for today will come from the line of Paul Treiber from RBC Capital Markets. Your line is open.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Hi, Paul.

A

Paul Treiber

Analyst, RBC Capital Markets

Thanks so much and good morning.

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Good morning.

A

Paul Treiber

Analyst, RBC Capital Markets

Just want to follow-up on the questions on QNX and automotive. And just to clarify has your enthusiasm for the automotive business changed at all from your prior comments? And then related to that, I think in the past you've mentioned about increasing that business by 3 to 5 times over the next three to five years. Is that still a reasonable outlook for that business?

Q

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

Yeah. The comments related to auto. And so the answer to your question, yes, we are still gunning for that and we don't have any reasons to believe that we should back off on it. I feel quite encouraged about the auto business. Just last couple of weeks I have spoken to many Tier 1 and OEM CEOs. I feel good about how they

A

view what we offer, the collaboration that they would want, the deals that we are bidding on, I don't see any slowdown or any reason to be concerned about the auto business.

In fact, we're probably going to step up more investment in QNX. We will add more engineers around the world, and especially in Canada. We have a number of announcements that comes out – that will come out to just kind of confirm our investment level, that we'll increase our investment level in this area.

And in addition, the operating system could be used in many different areas, including medical equipment and so forth, and we are looking at that too. So in addition to the auto, which we will grow and invest in heavily, there are also other verticals that could use it. And this is why I feel good about our Spark platform, because we could secure more endpoints beyond just the cars.

Paul Treiber

Analyst, RBC Capital Markets

Q

Okay. Thanks for clarifying that. Just one last question from me, and it's a problem that you have a probably good problem is just on the cash and potential uses of cash. You've talked about M&A and share buybacks to potentially offset the dilution. Do you have any updates on that, particularly in other words the M&A with valuations are where they are, and then also maybe share buybacks?

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Yeah. We are not really doing much buyback. The reason is when we do our calculation, we believe that cash for our shareholders' return is best used on expanding the business and expanding the capability. I'm a very cautious guy and you could use the word cheap. I don't think I'm cheap. I'm just a value seeker. What I don't want to do is to buy very, very high multiple. There are number of interesting opportunities out there. We have a team of people that they go around and they try to understand the landscape and the company and so forth.

So, acquisitions continue to be a high priority item for us. We will be very careful not to be – not to over pay. This market, as you will agree, is going higher, and sometimes for very little reasons that I could not understand, but then I'm not you guys. It's not my day job. But because of that, I'm a little cautious of jumping in and paying high multiples.

So, I guess, I'm doing a wait and see there a little bit. So, in the meantime, we have plenty of things to do ourself organically. We're building our ISS technology. Next week we're going to announce some new stuff. So, we're quite busy ourself, but we will do some acquisitions. Buyback is currently at the back burner.

Paul Treiber

Analyst, RBC Capital Markets

Q

Okay. Thanks for taking my questions.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

A

Absolutely. Okay. I think that was that, right. Thank you.

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

A

Thank you.

John S. Chen

Executive Chairman & Chief Executive Officer, BlackBerry Ltd.

So, thank you. Before I close the call, I'd like to put a pitch for our marketing group that we have our Security Summit in New York next week. And I think it's next Thursday, Friday, I don't remember correctly. But I hope that I could see some of you there or most of you there. Thank you for the time that you spent with us today, and have a good day.

Steven M. Capelli

Chief Financial Officer & Chief Operating Officer, BlackBerry Ltd.

Thank you.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.

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