

BlackBerry Limited

Third Quarter Fiscal Year 2022 Results Conference Call

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CORPORATE PARTICIPANTS

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Steve Rai, *Chief Financial Officer*

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CONFERENCE CALL PARTICIPANTS

Dan Chan, *TD Securities*

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Daniel Park, *Canaccord*

Paul Treiber, *RBC*

PRESENTATION

Operator

Good morning and welcome to the BlackBerry's Third Quarter Fiscal Year 2022 Results Conference Call. My name is Charlie and I will be your conference moderator for today's call. During the presentation all participants will be in listen-only mode. We will be facilitating a brief question-and-answer session towards the end of the conference. [Operator Instructions] As a reminder this conference is being recorded for replay purposes.

I would like to turn the call over to Tim Foote, Investor Relations. Please go ahead sir.

Tim Foote

Thank you, Charlie. Good afternoon and welcome to BlackBerry's third quarter fiscal 2022 earnings conference call. With me on the call today are Executive Chair and Chief Executive Officer, John Chen; and Chief Financial Officer, Steve Rai. After I read our cautionary note regarding forward-looking statements, John will provide a business update, and Steve will 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 US 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. These factors include the risk factors that are discussed in the company's annual filings and MD&A, including the COVID-19 pandemic. 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 results. For reconciliation between our GAAP and non-GAAP numbers, please see the earnings press release published earlier today, which is available on the EDGAR, SEDAR, and Blackberry.com website.

And with that, I'll turn the call over to John.

John Chen

Thank you. Thank you, Tim. Good afternoon, everybody. Thanks for joining the call today. I'm pleased to report that this quarter, we delivered solid sequential billings and revenue growth in both our IoT and Cyber business unit and beat expectations. I'm also pleased that despite our ongoing investment to grow the top line, EPS coming much better than expected. Let me start my review with the IoT business unit.

Revenue was \$43 million, representing a 34% year-over-year growth, although noting that last year was heavily impacted by the pandemic. Gross margin was 81% and IoT ARR increased to \$91 million. This is now the third consecutive quarter in which ARR has increased.

This was a very positive quarter for QNX, driven by continued strength in design wins activities. We achieved record quarterly revenue from development seat license and as well as associated professional services. In fact, demand is so strong right now that we're expanding our professional services team by hiring additional heads into QNX.

In addition to the near-term revenue benefit, these strong design wins serve as a positive leading indicator of the longer-term health of the QNX business overall. Once completed, obviously, this design will move into production and generate royalty revenue in future quarters.

In terms of production-based royalty this quarter, we saw a modest increase compared to Q2. While we expect the auto industry supply chain issues to remain a meaningful headwind to vehicle production volumes through the end of this fiscal year and as well as into 2022, we see the impact on QNX gradually lessening, including an improvement in Q4 versus Q3.

I will now provide additional colors around the design wins in the quarter. The continued strength we are experiencing is further evidence of our leadership position in auto. We are certainly not taking this position for granted and continue to invest in all aspect of the business. In the quarter, we have a major win with BMW. BMW enter a multi-year agreement with us to develop new Level 2 and 2+ autonomous drive system on QNX for makes and models across the entire BMW Group.

Autonomous drive is the clearest example of safety-critical software application in a car, which, as you know, is the most defensible attributes of QNX. BMW selected QNX because of our deep expertise and strong track records in safety, reliability as well as security. In addition to licensing our technology, we will be providing a professional services team to support BMW in their aggressive development timeline.

Other auto wins include a major new design product for our acoustic middleware, one of our higher ASP products. We also had a number of ADAS, Advanced Driver Assist, ADAS, gateway and digital cockpit design wins with leading OEM and Tier 1.

In Q3, we have a total of 11 new auto design wins and 13 wins in the general embedded market. GEM, the general embedded market, wins included a number of medical applications such as an infectious disease diagnostic platform as well as a next-generation robotics surgical arm.

We also have wins in industrial applications as well as aviation, including an engine simulator with a leading aerospace company. With any luck, we'll also be able to share details of further significant auto design wins with you all at the CES in January.

A word on product development, during the quarter, Google, Qualcomm and BlackBerry, three of the leaders in the autonomous digital cockpits, announced a collaboration to build a chipset that allows BlackBerry's Hypervisor to seamlessly integrate with Android Automotive. We are already seeing the results, securing the first design wins with this technology with a major European OEM in the quarter.

Previously, to develop a digital cockpit with an Android Automotive infotainment system running alongside safety critical application on a single chip will require hundreds of hours of expert developer time for building custom integrations. This collaboration takes care of this for the customers, saving them both cost and time to market as well as delivering a higher quality product.

The auto industry continues to move towards consolidation, particularly consolidating digital cockpits. With this position, QNX will be even more strong in that space, given the safety requirements. This provides the potential to win additional designs that will include both our Hypervisor and our RTOS, our QNX operating system.

Turning to the Q4 outlook for the IoT business, the strength we have seen in design activities is expected to continue into Q4 and we anticipate a slight easing in supply chain headwinds. As a result, our outlook is for further sequential revenue growth and for Q4 revenue to be the range of \$50 million to \$55 million, returning to the pre-pandemic run rate. We feel very good about the IoT business right now, but investors should keep in mind that the auto industry's production headwinds.

I will now provide a brief update on IVY. We released the early-access version of IVY in October as we have previously targeted. This version has been released to a small number of ecosystem partners and will form the basis of our product demonstration at CES in January.

This quarter our co-development partner, AWS, announced the launch of a complementary product for IVY called AWS IoT Fleetwise. While IVY is cloud agnostic and can work with any major cloud provider, AWS IoT Fleetwise is a microservice that allows IVY insights to be efficiently and intelligently uploaded into the AWS cloud where they can support cloud-side applications.

Another significant development for IVY is that Bosch, the world's largest auto Tier 1 supplier, announced that their new Cockpit Integration Platform will support IVY. This platform was built on QNX RTOS and Hypervisor, showing the potential for upselling IVY in future designs to the large and growing QNX installed base. Our main focus for IVY right now is on securing POC, proof-of-concepts, and we are hopeful that we can announce some in the near future. Overall, we're pleased with the progress being made.

Let me now move to the Cyber side of business. This quarter, we delivered sequential billings and revenue growth for the second consecutive quarter. Revenue was \$128 million. Gross margin was 59%. ARR was \$358 million. Dollar-based net retention was 95%. We saw continuous growth in pipeline for our unified endpoint security products, in particularly our managed service offering, Guard.

We are very excited about how our products performed in head-to-head bake off against other next-gen competitor this quarter. When we get to a POC, our technology performs well, as illustrated by competitive wins against CrowdStrike and SentinelOne, as well as other older signature-based players like Microsoft, McAfee, and Symantec. Among these wins was another top 10 global automakers, building on the win with a top 10 OEM we told you about last quarter.

Other notable competitive wins include an international banking group, a leading European financial services firm, and a global marketing agency. In addition to success with larger companies, we are seeing a lot of interest from small and medium-sized businesses too and this will continue to be an area of focus for us as the market opportunity is large.

Our automated Protect and Guard managed service offerings really resonate with small and medium-sized companies that don't have a large security infrastructure. POC often involve customers performing rigorous testing of our product against the competitor's and the success we are having is illustrating our competitive advantages. Let me highlight a few of those key ones.

The first is our focus on prevention, with customer testing demonstrating that we stop threats pre-execution. This contrasts to the EDR approach that aims to remediate threats after the fact.

The second is artificial intelligence. Whereas for others AI is relatively new and even an optional feature, our Cylance AI engine is central to our technology. It is the most mature in the market, having learned from the analysis of trillions of files and literally identify over 20 billion characteristics.

The third advantage we have is our EPP, works both offline and online, our protection. Endpoints are protected 24/7 and don't rely on cloud connection which is, of course, cloud connection could be very expensive.

Fourth, we protect mobile. Nobody in this space know mobile as better than BlackBerry. I hope you agree with that and it is rapidly becoming one of the largest threat surfaces. These four attributes differentiate BlackBerry's security offerings from the competitor.

I'm sure you all heard about the major security incidence known as Log4Shell, which CISA has classified as a maximum level 10 for severity. This relates to major vulnerabilities in Apache Log4j Java library, extensively used by the industry. Let me provide you with an update from a BlackBerry perspective. This is obviously a rapidly evolving situation and unlike many software companies who are still struggling to understand the impact, we track and categorize our product portfolio's Open Source Software content. This mean that we are able to very quickly identify which of our product uses this library and create

mitigations and release patches as the threats evolve. We can confirm that none of our core products, namely Protect, Optics, UEM, QNX RTOS, and Hypervisor, none of those products are negatively impacted by these vulnerabilities.

Furthermore, our suite of Cyber products, particularly our Protect, EPP, and Guard Managed Service, can help customer prevent malware and ransomware that bad actors could try to execute using these vulnerabilities.

Now, for a brief update on key partnerships, in recent quarters, we have released a number of new products and announced partnership that expand our Extended Detection and Response offering or XDR. In the quarter, we were excited to announce partnership with Okta and Mimecast as well as Stellar Cyber and XM Cyber.

And then a significant XDR partnership is with Exabeam, the leading next-gen SIEM provider. This partnership allows us to greatly improve both context and the visibility of threats by adding telemetry data from hundreds of network integration to our Guard managed XDR service. Managed XDR is a strong market opportunity given the complexity of managing threat across the network.

Finally, we are pleased that during the quarter, SE Labs, a leading independent cybersecurity research firm, ranked BlackBerry as the best new endpoint protection solution of 2021.

A few words on customer wins. Across the business unit, our key verticals this quarter were government, banking and insurance. In government, we closed business with some of the world's leading governments and government agencies, including the US Navy who became a new secure voice customer. The Department of Homeland Security, the Dutch government, the US Department of Education, which happened to be a new logo wins for AtHoc, displacing key competitors as well as Scottish government; US Central Command, the Federal Aviation Authority and the IRS, just to name a few.

Moving to the outlook for the Cyber business, we expect continued sequential billing growth in Q4 and for Q4 revenue to be in the range of \$125 million to \$135 million. As previously indicated, I think I said it last quarter, closing certain large government deal in Q4 will be important.

Moving on to Licensing, as you know, we have been in negotiation regarding the sale of our non-core portion of our IP patent portfolio. This process is taking much longer than we had hoped and trust me, I share the frustration about the timeline. Negotiation are very close to a conclusion and we are literally down to the last few important items now. Both parties are working hard to get this finished and we expect to reach a definitive agreement very soon. We will provide shareholders an update on progress in January.

In the quarter, Licensing revenue was \$13 million and gross margin was 54%. This beats expectation for the quarter. Should the sales reach a definitive agreement in January, we will suspend monetization activity and therefore expect Q4 revenue to be close to zero. However, if not, then we'll continue to expect revenue to be around the \$10 million mark for the quarter.

I'll now hand over to Steve to provide additional colors on the financial.

Steve Rai

Thank you, John. My comments on our financial performance for the third quarter will be in non-GAAP terms unless otherwise noted. Please refer to the supplemental table in the press release for the GAAP and non-GAAP details.

We delivered third quarter total company revenue of \$184 million. Third quarter total company gross margin was 64%. Our non-GAAP gross margin excludes stock compensation expense of \$1 million and our third quarter operating expenses were \$142 million. Our non-GAAP operating expenses exclude \$29 million in amortization of acquired intangibles, \$5 million in stock-compensation expense and a \$110 million fair value gain on the convertible debentures. Given our ongoing investment towards driving top line growth in our core IoT and Cyber businesses, in the third quarter, non-GAAP operating loss was \$24 million, and the third quarter non-GAAP net loss was \$1 million.

We recorded a non-operating gain of \$25 million as a result of gains realized in two legacy venture investment funds that make up the majority of the long-term investment balance on our balance sheet. Related to this gain, the investments underlying these funds represent a passive interest we had, which were sold and we received a cash distribution of approximately \$35 million during the quarter.

Non-GAAP earnings per share was breakeven in the quarter. Our adjusted EBITDA was negative \$8 million this quarter, excluding the non-GAAP adjustments previously mentioned.

I will now provide a breakdown of our revenue in the quarter. Cybersecurity revenue was \$128 million and IoT revenue was \$43 million. Software product revenue remained in the range of 80% to 85% of the total, with professional services comprising the balance. The recurring portion of software product revenue remained at approximately 80%. Licensing and Other revenue was \$13 million given the limitations to our monetization activities due to the potential IP portfolio sale.

Now, moving to our balance sheet and cash flow performance, total cash, cash equivalents and investments were \$772 million as at November 30, 2021, remaining consistent during the quarter. Our net cash position remained at \$407 million. Again, given our investment in our core software business is third quarter free cash flow was negative \$21 million. Cash used by operations was \$19 million and capital expenditures were \$2 million.

That concludes my comments and I'll now turn it back to John.

John Chen

Thanks, Steve. Before I move to the Q&A, let me summarize the key points for the quarter. We are pleased with how our new organization structure is executing right now. We saw strength in design activities for our QNX business, achieving a record quarter for design-related revenue and it looks like it will continue.

Macro supply chain headwinds are still impacting vehicle production, but we see an improving picture heading into Q4. We made good progress with IVY, including releasing the early-access version of the product.

On the Cyber side, we again see sequential growth in billings and revenue, including more head-to-head wins against our key competitors. The ongoing Log4Shell incident is a great example of the huge Cyber

market opportunity, and also showcase our capabilities. While others are struggling to identify the impact on their products from open-source code, we're responding rapidly and effectively.

Overall, BlackBerry delivered solid progress. We delivered solid progress, beating both revenue and earnings expectation for the quarter. So, Charlie, please start the process of Q&A.

Operator

Sure. No problem, sir. And we will now begin the question-and-answer session. [Operator Instructions] Our first question from today will be from Daniel Chan with TD Securities. Please go ahead.

John Chen

Hi, Dan.

Dan Chan, TD Securities, Inc.

Hi, guys. Hi, John.

John Chen

Hi.

Dan Chan, TD Securities, Inc.

Can you provide any color on their Cybersecurity ARR? Looks like it declined to \$358 million from \$364 million quarter-over-quarter. Just wondering if there's any churn and which products may have been affected and maybe if any products are showing outside strength.

John Chen

Yeah. We had a positive surprise with higher revenue, more than we expected from our SecuSmart product. So that is what principally drove the numbers that you saw.

Dan Chan, TD Securities, Inc.

Okay. And then the guidance that you provided for next quarter, what are the puts and takes in that guidance? Thank you.

John Chen

Yeah. So, let me just break it into two pieces, IoT versus Cyber. On the IoT side, touch wood, I think we're all feeling pretty good about it. As I said, we're going to get back to a pre-pandemic level. Design wins are good. That brings – we have a good pipeline and backlog of professional services to help the customers to deploy our technology as well as developer seats. And as I said earlier, the royalties, we expect to uptick a little bit from Q3, so that kind of composes the math for the guidance between \$50 million to \$55 million. Feel okay about that. I don't want to jinx it, but it looks okay.

On the Cyber side, it relies on a number of deals that are quite big from the government side, from a revenue perspective because of the fact that we expect these to close a little later in the quarter. So, the revenue contribution will not be as big as if it's obviously at the beginning of the quarter, but the billings will look fine.

Dan Chan, *TD Securities, Inc.*

Thanks, John. Happy holidays.

John Chen

Sure. Sure, Dan.

Operator

Your next question comes from the line of Trip Chowdhry with Global Equities Research. Please go ahead.

John Chen

Oh, hi.

Trip Chowdhry, *Global Equities Research LLC*

Hello. Thank you, very good execution on the quarter. Few things I would be interested in is related to the IVY platform. You had the early-access program on those now for two months. Any specific data points you would like to share maybe in terms of download applications or partners, any reaction? And then I have a...

John Chen

Yeah.

Trip Chowdhry, *Global Equities Research LLC*

...follow-up question.

John Chen

Okay. So yeah, we of course released it to the application partners and a handful of OEMs, car manufacturers. The feedback was very positive. As I said earlier, we're going to use that as a basis of our demonstration at CES at our booth. And we're also going to digitize and stream that, those sessions. I'll talk a little bit about that later.

So, a positive response, lots to do, a lot of activities going on. The applications, as you know, we have announced a few applications. I can't promise every single one of them you will see at our booth. We have the battery management system. We have the car as a wallet. We have other rideshare applications. So,

I don't know whether every single one of them will make it to our booth, but I expect quite a number of them will.

And you'll also see a cockpit – sorry, Trip. You also will see a cockpit that we collaborate with Amazon or AWS.

Trip Chowdhry, *Global Equities Research LLC*

Beautiful. Then also, if we look at the new generation EV players and also the old guard of automobile players, they seem to be now getting on the bandwagon of over-the-air updates. I was wondering, does your platform, whether it's IVY or QNX, provide over-the-air updates just out of the box?

John Chen

Yes, QNX has an option for OTA. Of course, IVY has to have the OTA. The physical link is a simple thing and we do have it. And the more important thing that I talked about earlier about the new AWS, the new Amazon release is called Fleetwise; allow a logical link between the edge of the car to the cloud. We're taking advantage of that microservice. So, yes, we do – it's obviously both ways, from the cloud to the car and then vice versa. So, from data and code, we do have OTA capabilities already.

Trip Chowdhry, *Global Equities Research LLC*

Very good. So, looking forward to seeing your announcements at the CES show.

John Chen

Great. Thank you, Trip.

Trip Chowdhry, *Global Equities Research LLC*

Thank you.

John Chen

Thanks.

Operator

Thank you. Your next question comes from the line of Mike Walkley with Canaccord. Please go ahead.

John Chen

Hey, Mike.

Daniel Park, *Canaccord Genuity LLC*

Hey, guys. Good afternoon. This is actually Daniel on for Mike. Thanks for taking the questions.

John Chen

Okay.

Daniel Park, Canaccord Genuity LLC

So, yeah, I guess with John Giamatteo joining your Cybersecurity unit last quarter, just want to see how the productivity of your investments in your quota-carrying sales reps are trending in this area of your business and how should we think about some of the sustained investments as we move into 2023?

John Chen

Good question. John joined us and the exciting part of that is that John has enormous experience in the cybersecurity market. He ran a \$3 billion business as a President and CRO of McAfee before. And so, he is very relevant, and he brings in a lot of relationships, particularly with customers and partners. So, that's very good and he knows how to make salespeople successful in the cyber world.

So, I don't know how to describe productivity, but I could tell you one data point that, today, we have 10% more quota carriers, we call them direct quota carriers. We have 10% more direct quota carriers than a year ago – or the beginning of the fiscal year, sorry, than the beginning of the fiscal year. We did the math that way. And the productivity, we will start seeing that as a lot of them are new because we recently hired them, we would see those coming in the next few quarters.

As you think about the sales cycle, let's say, two to maybe three quarters, call it three, I should be seeing some results in either the second quarter or the third quarter next year.

Daniel Park, Canaccord Genuity LLC

Okay. Great. Thanks for the details, John. And, yeah, just as a follow-up, so you noted you saw further pipeline growth within Cybersecurity and you also expect sequential billings growth in Q4. When should we expect this to start showing up in ARR?

John Chen

Oh, well, next year, I hope. So, I feel pretty good about mathematically that we're looking for a good ARR growth next year.

Daniel Park, Canaccord Genuity LLC

Okay. Great. Thanks for the details.

John Chen

Sure.

Operator

Thank you. [Operator Instructions] Your next question comes from the line of Paul Treiber with RBC Capital Markets. Please go ahead.

John Chen

Hey, Paul.

Paul Treiber, RBC Capital Markets

Hey, John.

John Chen

Hey, Paul.

Paul Treiber, RBC Capital Markets

Good afternoon.

John Chen

Good afternoon.

Paul Treiber, RBC Capital Markets

Within IoT, I mean it seems like you're quite upbeat on the design win-related revenue like developer seats and professional services. What's a typical gap like in duration between professional services work and when it goes into production? And then also, is there a ratio like for every \$1 professional services and design – developer seats to ultimate the royalty revenue that you may see.

John Chen

No, there is no – there is really no direct ratio. It's really that some OEMs want a very aggressive development schedule. So, they used to – in that case, they will ask us to provide some expertise and of course, we – under the professional services program. And then they will typically buy a higher number of developer seats because they want to put more engineers on it in parallel.

Some want to do it a little bit more sequentially. I would tell you that if you ask our folks, that we're seeing the former – the people are more aggressive with timeline. They are not because whether you're an autonomous vehicle design or whether you're an electric vehicle design or the combination of both, competition is heating up in the auto industry, as you all know. So, time to market is important to them unlike the kind of the old rule of thumb that a new model come out the last 10 years and it usually takes five to seven years to get a new model out from conception to production. I think those are very much collapsed partly because by players like Tesla of the world and a lot of the Chinese players, their development cycle and sales cycle are a lot shorter than the manufacturing cycle. So, there isn't really a –

you buy more developer seats and therefore, you have long – bigger production royalties. I don't think there is a real cause and effect there or relationship there.

Now, typically, as I said, we see a developer – a win and then developer seat licenses as well as professional services. Usually, you add about three years down, you start seeing production. Nowadays, I have seen numbers that are a little bit off; plans, I shouldn't say numbers. Plans are a little bit more aggressive than that, but a typical cycle will be three to five years from win to seeing the royalty start growing. And once the royalty start growing, usually lasts in excess of seven years.

Paul Treiber, RBC Capital Markets

Great. Thank you. That's helpful. Just one follow-up question. Sales and marketing, I was under the impression that you're planning to ramp it up more significantly. I'm seeing flat this past quarter. How should we think about sales and marketing spending from here?

John Chen

Yeah. Sales and marketing will both definitely ramp-up. I could tell you, John Giamatteo on the Cyber side, we don't do as much of marketing in QNX or IoT because especially in the auto space and some of the GEM vertical, we are already a reasonably well-known name and known entity, so we don't need to do as much.

On Cyber, as you know, we need to do quite a bit. So – and John is very – John G. is very focused on it. So, you will see that going up and going up quite a bit, in fact.

Paul Treiber, RBC Capital Markets

Okay. Thank you for taking my questions.

John Chen

Sure.

Operator

And we have no further question at this time. I would like to turn the call back over to John Chen, Executive Chair and CEO of BlackBerry, for closing remarks.

John Chen

Thank you, Charlie. Okay. Thank you, everybody, and as we mentioned, we're participating at CES in Las Vegas in January. The focus will be on IoT business and how it addresses the benefit from the key trend in edge computing. No doubt, a key highlight will be the demonstration of our IVY technology, including illustrating how IVY use edge computing to create insight or sensor data, both hardware and software-defined sensor. We will be hosting a hybrid in-person and live stream demonstration of the IVY technology followed by an investor Q&A session with Mattias Eriksson, the President of the BlackBerry IoT group at 8 AM Pacific on Thursday, January 6. We'll be releasing more details about this shortly.

I'd like to wrap up by wishing all of you thank you for joining us and wishing all of you and investors and everyone on the call here a happy holiday and a safe and successful New Year. Thank you very much.

Operator

And this concludes today's conference call. Thank you for your participation. You may now disconnect.