

BlackBerry Limited

Fourth Quarter and Fiscal Year 2022 Results Conference Call

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CORPORATE PARTICIPANTS

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Steve Rai, *Chief Financial Officer, BlackBerry Ltd.*

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CONFERENCE CALL PARTICIPANTS

Dan Chan, *TD Securities*

Trip Chowdhry, *Global Equities Research*

Paul Treiber, *RBC*

PRESENTATION

Operator

Good afternoon and welcome to the BlackBerry Fourth Quarter and Full Fiscal Year 2022 Results Conference Call. My name is Brent, and I will 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. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes.

I would now like to turn today's call over to Tim Foote, BlackBerry Investor Relations. Please go ahead.

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Tim Foote

Thank you, Brent. Good afternoon and welcome to BlackBerry's fourth quarter and full fiscal year 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. You should not place undue reliance on the company's forward-looking statements. Any forward-looking statements are made only as of today and the company has no intention and undertakes no obligation to update or revise any of them 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 full year results. For a 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 websites.

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

John Chen

Thank you, Tim. We have to change the intro of the script now. Tim just made Vice President. Congratulations.

Tim Foote

Thank you, John.

John Chen

Good afternoon, everybody, and thank you for joining the call. Let me start today with the IoT business unit. I am pleased to report that we recorded the first \$50 million-plus quarter since the start of the pandemic despite the ongoing challenges for the auto industry.

Revenue for the quarter came in at \$52 million, which is 21% sequential increase, and 37% year-over-year growth. Gross margin also increased to 85% and IoT ARR increased for the fourth consecutive quarter to \$93 million, which is up 11% year-over-year.

In addition to seeing a modest increase in production-based royalties, we set another new record for quarterly revenue from design activities. This revenue comes from development seats and professional services used by the customers to design our QNX software into vehicles and other IoT endpoints.

This strength not only delivers near-term revenue, but also points to long-term business volume once these designs enter into production. In addition, we have a good line of sight to upcoming professional services backlog from confirmed design wins and are hiring additional heads to meet the demand. We also have good visibility into the pipeline for potential new design wins in FY 2023.

In terms of royalties, as I said earlier, we saw some improvement in volume this quarter. However, the challenges for production remain. Major OEMs have indicated continuing supply chain headwinds, particularly chip shortages, although they expected the situation to largely improve as the year progresses. The conflict in Ukraine has added further disruption to an already challenging environment for the auto industry, and we will continue to monitor that impact.

You may recall that over the last few years, we have seen a significant increase in the proportion of the QNX business from safety-critical foundational software, such as ADAS (Advanced Driver Assist), digital cockpits and autonomous drive. This now constitutes the largest part of the total business overtaking infotainment.

This strategy to focus on functional safety, plays to QNX's strengths and is validated by both the market trends towards ECU consolidation, as well as the software-defined vehicle. We also see significant growth in safety-critical design opportunities in our pipeline.

Gross margin in the quarter improved from 81% to 85%. This is largely driven by the improvement in production royalties. Royalties are due when the vehicle is shipped and there is low cost for us at this stage of the design life cycle; meaning, they have a high gross margin.

Let me now turn to the new design wins we secured in the quarter. This was a record quarter in terms of the number of new design wins. We recorded 17 new auto designs and 28 wins in the General Embedded Market.

ADAS registered the most wins in the quarter, followed by digital cockpits and instrument clusters. Once again, we won business with leading automakers and Tier 1 suppliers including Hyundai, NIO, Bosch, Visteon, Denso, and this is special for Tim, Skyships, for the new Gordon Murray T50 Hypercar. I just read it. I've seen the picture of it, I should say. Tim showed me the picture. He was quite impressed with that.

In GEM, we recorded wins in multiple verticals including Defense and Aerospace, industrial, as well as Medical, our strongest GEM segment. Like in auto, we have the highest level of functional safety certification for medical, and we're seeing increased momentum there. Design wins this quarter included analytical devices for use in medical labs, as well as for surgical robots.

Let me now turn to IVY. At CES in January, we demonstrated the product running with live data on auto-grade hardware. This demonstration formed the basis of many constructive meetings with OEMs and as a result, we had multiple additional requests to start proof-of-concept, or we call it POC trials.

We currently have more requests than we could handle, which is a nice problem to have. The first POC is with a Chinese EV (Electric Vehicle) automaker, and PATEO, a leading Chinese Tier 1 supplier. Their plan is to integrate IVY into the digital cockpit. The expectation is for successful POCs to lead to design wins, i.e., a commitment from customers to design IVY into vehicles.

The CES demonstration also allowed us to showcase two of our many potential applications that IVY can enable. Car IQ's in-vehicle payment and Electra's AI-driven battery management application were both very well-received by OEMs and are included in the IVY POCs. IVY product development remains on track and last month, we released the latest version of the product that is POC-ready.

Let me now move into the Cybersecurity side of the business. This was the third consecutive quarter of sequential billings growth. Billings not only grew double-digit versus Q3, but they also increased year-over-year. Cyber revenue was \$122 million. Gross margin improved by 200 basis points to 61%. ARR was \$347 million and dollar-based net retention was 91%.

Market conditions for our Cybersecurity products are positive. This is in part because of the ongoing heightened level of cyber threats. Our Guard managed XDR cybersecurity team, in line with other leaders in the space, has seen a significant increase in threats in recent weeks. In particular, wiper malware that aims to take the victims' service offline is at an unprecedented level.

Some of the most prominent examples of this currently identified across the industry, including HermeticWiper, that has been seen in cyber-attacks in Ukraine, Latvia and elsewhere.

Logs have shown that our product, our Protect product, Protect EPP, has been blocking this malware at BlackBerry customers' sites before it could execute. The same is also true for WhisperGate, another leading example of wiper malware that has targeted the Ukrainian government as well as the Ukrainian non-profit and IT organizations.

In fiscal year 2022, we released 48 new products. Among the cyber security products, pipeline growth is strongest for the following three: Gateway Zero-Trust Network Access, or ZTNA; Guard managed service; and Persona Behavioral Analytics.

On the marketing front, we're going to leverage the strength of the Cylance brand for our Cyber products. The brand resonates strongly with customers and across the industry.

Investors have said that hearing how our Cyber products are competing out in the field is helpful. So let me provide you with a couple of recent wins, recent examples of wins. The first is with a leading publicly traded medical supplies conglomerate based in the United States. The customer like many others was struggling to staff a 24/7 security operations center, and held a competitive tender process between BlackBerry, CrowdStrike and Arctic Wolf. They bought more than 10,000 licenses of our Guard managed service due to BlackBerry's performance and security credentials.

The second is with a leading manufacturer based in Asia that selected BlackBerry over CrowdStrike, Fortinet, and Carbon Black. Following a detailed POC, they selected BlackBerry because of our products' strong performance, uncovering multiple threats during the trial.

Legacy signature-based vendors still account for a significant portion of the overall market especially with SMB customers. This was always an area of focus for Cylance. An example of a recent win there was with a logistics company that held bakeoff replace their current McAfee and Microsoft Defender Solution. After a rigorous assessment that included McAfee, Symantec and CrowdStrike, they bought approximately 2,000 three-year licenses for our Guard Advanced product, because we detected a number of threats that others didn't and as well as providing a higher level of customer service.

Let me also provide you with an update on talent acquisition. Building on the progress we made last year in ramping the sales force, we have been successful in adding further industry experience to the Cybersecurity expertise we already have at BlackBerry. This quarter, we not only recruited sales leaders from direct rivals but product development leaders also. Cyber is a hard market for talent right now, so we're really pleased about our ability to attract and retain high-quality people.

As stated earlier, ARR came in at \$347 million. This is a decrease of \$11 million compared to the prior quarter and was driven by two key factors. The first factor was that in January, we ceased operations for legacy BlackBerry mobile devices. This move allows us to save significant infrastructure costs going forward. However, revenue for the Enhanced SIM-Based Licensing, or we call it ESBL, are also ended as a result.

The second factor impacting ARR was a churn in smaller UEM customers. Recently, we have seen a trend towards some less feature rich UEM products being sold by some of our competitors as part of the bundles or enterprise license agreements.

BlackBerry UEM, on the other hand is a premium product, that offers a very high level of security. We've seen some smaller, more price-sensitive customers choose to use the "free" UEM product that comes with their bundle to save incremental cost at the expense of security. However, these customers represent a relatively small portion of our UEM base. It is also important to note that our leading security profile continues to resonate strongly with our larger, core customer base of the largest banks and government agencies.

To reinforce this point, this quarter, we secured UEM renewal with the U.S. Air Force, the U.S. Department of Defense, the U.S. National Grid as well as a number of international governments, including Poland's Ministry of Foreign Affairs, Northern Ireland Department of Finance and Personnel, along with the Swedish and Italian governments just to name a few.

Among the major banks this quarter, we renewed with Deutsche Bank along with well-known American, Canadian and Indian banks, two major Swiss banks including the Swiss National Bank and a global credit card company. We also recently renewed for three years with global law firm White & Case. As a law firm, they handle confidential data on a continuous basis, and they felt that none of our competitors met their security needs better than BlackBerry.

During the quarter, we also successfully upsold Cylance Cybersecurity products to this and other UEM customers. It is likely that we will continue to see some headwinds for UEM in the near-term but we're taking steps to minimize the impact. This includes looking at ways to bundle BlackBerry UEM with other partners' product that appeal to the mid-market as well as continuing to develop new features that our customers value. Stay tuned for future updates on this.

Before I wrap up my comments on Cybersecurity, I'd like to share that going forward, we will start to provide quarterly billings information for our cyber business as part of our ongoing reporting. We believe that this will be well-received by shareholders and help them more clearly see the progress that the business will be making.

Moving on to licensing. On January 31 this year, we announced that we entered into an agreement for the sale of the legacy portion of our patent portfolio. The sale price is \$600 million, with \$450 million being due at the close, and the remaining \$150 million due in installments. I'm pleased to report that the transaction has successfully cleared the regulatory review stage, having received approval from the Canadian government's Investment Review Division on March 22, as well as the US HSR approval – the antitrust approval, that is – shortly before that. Completion of the remaining closing conditions, including financing is targeted for the end of this quarter.

Following the sale of the legacy portion of the IP portfolio, we will still retain all patents related to our core IoT and Cyber software businesses. We will, of course, keep the door open to all future monetization, but revenue is likely to be minimal in the near-term. Upon the closure of the deal, we expect a reduction in the operating costs required to maintain our IP portfolio.

Also, our cash position will be strengthened, enabling us to further invest for growth in our core markets, i.e., QNX, IVY, as well as Cyber. We will invest both organically and inorganically. In the quarter, licensing revenue was \$11 million, beating expectations; gross margin came in at 55%.

I'll now hand over to Steve to provide additional color on the financials. Steve?

Steve Rai

Thank you, John. As usual, my comments on our financial performance this past quarter will be in non-GAAP terms, unless otherwise noted. And also, please refer to the supplemental table in the press release for the GAAP and non-GAAP details.

Total company revenue for the quarter was \$185 million. Fourth quarter total company gross margin was 68%. Our non-GAAP gross margin excludes stock compensation expense of \$1 million.

Fourth quarter operating expenses were \$117 million. Our non-GAAP operating expenses exclude \$22 million in amortization of acquired intangibles, \$4 million in stock compensation expense, and a \$165 million fair value gain on the convertible debentures.

As John mentioned, we are continuing to invest in our core IoT and Cyber businesses, including head count growth and new product development to drive top-line growth. The planned investment is sizable. We expect to increase head count by approximately 250 people across both of our core business units this fiscal year.

This quarter, non-GAAP operating profit was \$8 million; and non-GAAP net profit was \$6 million. Our basic GAAP earnings per share was \$0.25, while non-GAAP earnings per share was \$0.01 in the quarter. Our adjusted EBITDA was positive \$20 million excluding the non-GAAP adjustments previously mentioned.

I will now provide a breakdown of our revenue in the quarter. Cybersecurity revenue was \$122 million, and IoT revenue was \$52 million. Software product revenue remained in the range of 80% to 85% of the total, with professional services making up the balance. The recurring portion of software product revenue remained at approximately 80%. Licensing and other revenue was \$11 million, given the ongoing limitations to monetization activity prior to closing the sale of the transaction that John referred to.

I'll now move to our balance sheet and cash flow performance. Total cash, cash equivalents and investments remained consistent at \$770 million as at February 28, 2022. Our net cash position remained at \$405 million. Despite the ongoing investment in the business, we generated positive free cash flow of \$8 million. Cash generated from operations was \$10 million, and capital expenditures were \$2 million.

That concludes my comments, and I'll now turn the call back to John.

John Chen

Thank you, Steve. Let me provide the outlook for the new fiscal year. Licensing revenue is expected to be minimal, excluding anything related to the patent sale. For the Cyber business, we expect to deliver billings growth between 8% to 12% this fiscal year, mainly as the result of increased traction from our security products. In fact, we expect to see higher billings in all four quarters when compared to the same quarter in the prior year. However, we model revenue for the year in total to be broadly flat year-over-year factoring in the time for billings growth to convert to revenue.

Despite having delivered three consecutive quarters of billings growth for Cyber, we're not satisfied with our results, particularly in ARR. We feel, however, positive about the trajectory of this business for a number of reasons. First is the Cyber market is strong, and demand appears to be getting stronger. Second, following our recent product enhancements, the performance of our products is being recognized, a good proxy for this is winning awards in independent testing, examples include receiving the maximum AAA rating in the SE Labs recent enterprise events security tests. Third is that we have increased the number of sales reps since the start of last fiscal year, and we'll continue to step up and expand hiring.

Our plan is to recruit more than 100 additional Cyber go-to-market personnel in the coming fiscal year. Fourth, we continue to record head-to-head wins against our competitors.

Now, switching to the IoT business. For the IoT business, we expect to see continued strong growth despite the ongoing headwinds for the auto industry. We expect revenue for the year to be in the range of \$200 million to \$210 million, representing a 12% to 18% growth year-over-year.

Despite the macro environment for the auto industry, we base our confidence on the following factors. First, the visibility of the backlog of professional services from design wins already awarded; second, the strong pipeline of potential new design wins this coming year; and thirdly, the upward trend in the royalty ASP in the new designs. We see a fairly even distribution of revenue across the four quarters.

Before we move to Q&A, let me quickly summarize the key points from the quarter. The IoT business is executing well despite industry level challenges, and we're encouraged by the line of sight we have for the years to come. IVY continues to execute well with both a new product release and strong demand for POC trials in the quarter. Our Cybersecurity business is tracking in the right direction, once again delivering solid billings growth and recording some encouraging head-to-head wins, and the sale of our non-core IP patent portfolio is progressing. Despite our ongoing investment in the business, we generated positive operating cash flow and net profit this quarter.

That concludes my remarks. Brent, could you please open the line for Q&A?

Operator

We'll now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of Daniel Chan with TD Securities. Your line is open.

John Chen

Hey, Daniel.

Dan Chan, TD Securities, Inc.

Hey, John. Another strong quarter of strong General Embedded wins. It's been a few quarters now where you've seen more General Embedded wins, other than auto. What is – how does the lifetime revenue stream look for some of these programs with respect to production royalties versus designs because I assume that some of these new wins in General Embedded have lower volumes than what you typically see in an auto space. So, can you just remind us how the revenue streams are structured for the General Embedded space?

John Chen

Yeah. You're talking about General Embedded, or you are talking about auto?

Dan Chan, TD Securities, Inc.

GEM, General Embedded.

John Chen

General Embedded, you see the production beginning a lot sooner on average, probably a couple of years out versus six or seven, or five or six years. And typically, not as big in terms of dollars. Overall, it is a big organization like a hospital or medical devices and the volume isn't as big as in the car industry, but it's still very, very healthy.

Now, General Embedded vertical, I think I mentioned medical, that's a really good fit. We're winning a lot. We have got good momentum in there and because of the safety certification. There are other General Embedded Markets that are really not as economically exciting, that's a better way to say it. So, we used to – we tend to stay away from those.

Dan Chan, *TD Securities, Inc.*

That's helpful. Thanks. And then on the head count increase, I think you mentioned you guys are budgeting for an increase of 250 people this year. I was just wondering where that's going. I think you mentioned 100 going towards Cybersecurity sales professionals, where the rest going?

John Chen

To IoT. IoT, a lot of them – I mean of course the sales personnel but also, we have a large backlog in professional services, so we need to fulfill the backlog and get the revenue.

Dan Chan, *TD Securities, Inc.*

Makes sense, thank you.

John Chen

Sure.

Operator:

Your next question comes from Trip Chowdhry with Global Equities Research. Your line is open.

John Chen

Hi, Trip.

Trip Chowdhry, *Global Equities Research LLC*

Hi, John. Another very strong quarter on Cylance. A very quick question, I was wondering like if you could put some more color to it, like what kind of activity was say before the Ukraine war and while we are in the war, you're getting a lot of interest in Cylance. Where is that interest coming from, is it from US-based companies or European-based companies or the whole world? Just provide us some anecdotal comments what you are hearing, I will appreciate that. And again, a very good quarter.

John Chen

Right. Thank you. Thank you. So, the Cybersecurity world is – there are lot of more threats and attacks, and we see raw demand growing. Like everybody else in the market has seen, the raw demand is really growing very fast. There is also a replacement market for the older generation, signature-based companies like McAfee, Symantec and Microsoft. So, you can see the second generation, the AI/ML-based company like ourselves and some other names and – key names in the industry. We could do a lot of – a good success rate in replacing legacy implementations. So that's the second one.

Cylance is particularly strong in the mid-market, small-medium business mid-market. And I think we have seen our activity pick up quite nicely partly because of Guard, that we released probably by now about a year ago. And we could see that trend up continuously every quarter. And so, the number is starting to become meaningful. So those are probably the drivers of what is happening.

And then last, but not least, remember, we've been hiring aggressively for over a year now in the sales head count. And so, it's starting to pay off in some areas. And last, but not least, we've been able to attract some very strong industry talent from the Cyber world and particularly under John Giamatteo, because he came from McAfee, and so he knows how to recruit a lot of those people and not only individuals, but also channel partners. So, things are starting to come together. Still have ways to go, but it's starting to come together.

Trip Chowdhry, *Global Equities Research LLC*

I just have one observation which is – just wanted to share with you. IVY platform, providing Machine Learning, AI-driven Battery Management System, none of that system which is AI-driven for BMS, Battery Management System, exists anywhere, not even the biggest EV manufacturer has that. I think this is very unique to your IVY platform. Keep it up.

John Chen

Okay. Thank you. Thank you much.

Operator:

[Operator Instructions] Your next question comes from Paul Treiber with RBC Capital Markets. Your line is open.

John Chen

Hey, Paul. Hi, Paul.

Paul Treiber, *RBC Capital Markets*

Hey, John. Thanks very much, and good afternoon.

John Chen

Good afternoon.

Paul Treiber, *RBC Capital Markets*

Just a question on go-to-market strategy in Cyber. And it's just, you mentioned UEM is obviously strong in the large enterprise, but then Cylance is strong in SMB. How do you bridge those two businesses from a go-to-market perspective because the customer base is – and your competitive advantages within each seem quite divergent?

John Chen

That's a great question. So, we now have three go-to-market teams that are coordinated by region under one senior management because of John G. And so, the pre-market go-to-market teams are – they think about strategic accounts, which are the large government, as well as banks, regulated industry, the SMB markets and the channel team.

So, our objective for the first team is to secure our base business in the strategic accounts and then upsell them with technology that could apply to that UEM base, for example, Zero Trust technology, which is – i.e. Gateway - is probably the most talked about concept right now, particularly the US government. The new Biden administration's budget has specific money allocated for Zero Trust and they want every agency and every Armed Forces to do that, to be able to implement Zero Trust as part of their overall Cybersecurity protection. So, we have that business and we're already in many of those institutions. So, the upsell of Cylance product into that space is the key to growth.

The second, SMB, has two-approaches. One approach is through the Guard services, the managed service, which SMB's typically need that kind of help to either augment their resources or to replace their resources because they can't hire fast enough. And so that led with the Cylance product and then we upsell UEM into it as more bundle oriented. And then of course, the channel is typically all Cyber and there are some good channel partners that are going to come online. I'm not at liberty to talk about it right now but in 90 days I will. So that's the kind of how we go in with each different type of category of customers. I hope that answers your question.

Paul Treiber, RBC Capital Markets

Yeah. That was helpful and I can't wait for the announcement in 90 days. Just second question, just on the sale of the patent portfolio, to the extent that you can, can you just walk through some of the assumptions in terms of like the longer-term outlook that went into that arriving at that price? Because one of the things that investors look at is you look at the revenue in that segment. In the previous year, it was quite a large number, how do we put the sale price in context to the previous revenue that you generated in that segment?

John Chen

Oh, okay. So, I would say there is still a lot of potential for this non-core set of assets but two things obviously. One is, time is ticking down on the life of this portfolio although we have a very young – we typically have and even with the non-core somewhere around 8 to 10 years type average lifetime with the patents still remaining, but if you notice that – which you pointed out the last couple of years or last few years, we had some good success but those are with very big names, and so now, we need to go – the business needs to go and cultivate pipeline for the smaller names which typically takes a little longer time, a lot more back and forth.

Big names do too, but big names at least have big numbers. So, in a way that the low-hanging fruits, we already approached and so I think the numbers we have done a market test of the numbers, we think is very fair to both sides.

Paul Treiber, RBC Capital Markets

Okay. Thanks for that explanation.

John Chen

Sure.

Operator

There are no further questions 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. I'm pleased to announce that on May 18, we'll be hosting a hybrid in-person and virtual Analyst Day from San Ramon, California. And some of the questions asked earlier regarding our go-to-market will be addressed by John Giamatteo and Mattias Eriksson, the two BU Presidents, and I will strongly suggest you don't miss it. In the case of Mattias, we're also going to prepare to talk annually about backlog, that we'll be during that call, that meeting also. So, I really encourage investor to join us and hear about key developments on our product and strategy as far as financial focus sessions that will provide additional color on the IoT and Cyber business.

More detail will follow in due course, so please stay tuned. Thank you for joining the call today, everyone, and have a good evening. I hope to see you in person soon.

Operator

Ladies and gentlemen, this concludes today's call. Thank you for your participation. You may now disconnect.