

## **FINAL TRANSCRIPT**

**Quarterhill Inc.**

**2017 Third Quarter Financial Results Conference Call**

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## CORPORATE PARTICIPANTS

### **Shaun McEwan**

*Quarterhill Inc. — Interim Chief Executive Officer*

### **Steve Thompson**

*Quarterhill Inc. — Interim Chief Financial Officer*

## CONFERENCE CALL PARTICIPANTS

### **Doug Taylor**

*Canaccord Genuity — Analyst*

### **Todd Coupland**

*CIBC World Markets — Analyst*

### **Rob Peters**

*Cormark Securities — Analyst*

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## PRESENTATION

### Operator

Good morning, and welcome to Quarterhill's 2017 third quarter financial results conference call. At this time, all participants are in a listen-only mode.

Following the management's presentation, we will conduct a question-and-answer session during which analysts are invited to ask questions. To ask a question, please press \*, 1 on your touch-tone phone to register. Should you require any assistance during the call, please press \*, 0.

Earlier this morning, Quarterhill issued a news release announcing its financial results for the third quarter ended September 30, 2017. This news release, along with the Company's MD&A and financial statements will be available on Quarterhill's website, and are now available on SEDAR and EDGAR.

On this morning's call, we have Shaun McEwan, Quarterhill's Interim Chief Executive Officer, and Steve Thompson, Quarterhill's Interim Chief Financial Officer. Following prepared remarks by Mr. McEwan and Mr. Thompson, analysts will have the opportunity to ask questions.

Certain matters discussed in today's conference call or answers that may be given to questions could constitute forward-looking statements. Actual results could differ materially from those anticipated. Risk factors that could affect results are detailed in the Company's Annual Information Form and other public filings that are made available on SEDAR and EDGAR. During this conference call, Quarterhill will refer to adjusted EBITDA. Adjusted EBITDA does not have any

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standardized meaning prescribed by US GAAP. Adjusted EBITDA is defined in the Company's quarterly and annual filings that are made available on SEDAR and EDGAR. Please note that all financial information provided are in US dollars unless otherwise specified.

I would now like to turn the meeting over to Mr. McEwan. Please go ahead, sir.

**Shaun McEwan** — Interim Chief Executive Officer, Quarterhill Inc.

Thank you, Operator. Good morning, everyone, and thank you for joining us on today's call. Q3 was a significant quarter for the Company with record financial results. It also marked the first quarter with a full contribution from our recently acquired businesses, IRD and VIZIYA. I'll start the call off with a quick look at our financial highlights, and then we'll spend a few minutes reviewing the quarter's operational highlights, and then what we see in our acquisition pipeline. Steve will then take a detailed look at the consolidated and segmented numbers, which will be followed by the Q&A.

Q3 revenue was 85.9 million, exceeding the high end of the range previously provided in our update announcement on October 2nd. Adjusted EBITDA was 60.6 million, also exceeding the high end of that range previously provided. As mentioned, these numbers reflect record levels for the business, and significantly eclipse our previous high-water marks.

Cash generated from operations was 9.3 million, which appears light compared to the performance that I just mentioned. The fact is that there was a significant increase in accounts receivable at quarter-end which affects this measure. Cash generated from operations will show a

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significant increase in Q4 2017, as we have now collected a large portion of our receivables that were outstanding at quarter-end, subsequent to quarter-end.

I am also pleased to announce that our Board of Directors has declared an eligible dividend of C\$0.0125 per share, payable on January 5, 2018 for shareholders of record on December 15, 2017.

Looking now at some of the factors that drove our strong Q3 results. WiLAN, our patent licensing business, was the key revenue and profit driver in Q3. Much has been said on recent quarterly calls about the variability inherent in the business model for patent licensing businesses, and in Q3, we saw just how this variability and our patient approach to licensing can in fact lead to very positive outcomes. We generated several licence agreements in Q3, including a new comprehensive agreement with Samsung, as well as licences with Motorola and G Talk, among others. We continue to have a large pipeline of licence opportunities in multiple geographies.

In Q3, WiLAN acquired a portfolio of patents related to content delivery network technology. This technology makes it possible for content providers to simultaneously send the same content to multiple client computing devices efficiently and reliably, even when bandwidth is limited or constrained. This type of technology is generally used by companies that offer video streaming services, and this portfolio was acquired under WiLAN's partner model.

Subsequent to quarter-end, WiLAN acquired a portfolio of patents which cover a variety of technologies, for securing data on storage devices such as self-encrypting drives. These improvements

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prevent unauthorized access to data in client devices, data centres, and on servers at the storage device level. These patents were purchased outright.

As we've been saying, WiLAN remains a key part of Quarterhill's investment portfolio, and we expect them to remain a world leader in patent licensing. We will continue to acquire portfolios to expand the partner program, and we'll invest prudently where appropriate returns can be met. And I would like to reiterate that the variability in the patent licensing business is going to continue, so we recommend that investors look at the WiLAN part of our business based on the value that it can deliver over the long term, rather than focusing on quarter-by-quarter numbers.

The third quarter, as I said earlier, was the first full quarter of operations for both IRD and VIZIYA. Results for both IRD and VIZIYA were slightly below our expectations for the quarter. That being said, we still feel it's pretty early on in the absorption of these businesses to pass judgment. We remain highly confident in their respective prospects.

IRD continued to build its order book throughout the quarter, announcing three new long-term contracts worth more than US\$10 million. These contracts, as well as several smaller ones executed during the quarter significantly add to the overall order book maintained by IRD. On the new product front, IRD formally launched its TACS, or T-A-C-S, which stands for Tire Anomaly and Classification System, which is a system built on its brand-new sensor technology called VectorSense. The product launch took place just last week at ITS World Congress in Montreal.

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TACS is a data collection system embedded in roadways, that captures a host of data when vehicles pass over it. Among other things, it can detect over or underinflation of tires, lane position, and unequal wheel loading. It provides valuable information for road structure designers, road management agencies, and toll authorities among others.

A pilot study in Oklahoma found that close to 100 percent of vehicles flagged by the TACS system had a tire anomaly, and within that group, 90 percent of the vehicles had tire issues requiring that the vehicles be pulled out of service until the repairs were made. This clearly highlights the safety features of the system, which is ultimately a benefit to both private enterprise and the public. IRD already has one TACS order in hand for North America and another in Europe, with more demos in progress. This is one of the data aggregation and analytics solutions that we are excited about, and that we see as a link to capitalizing on the industrial IoT opportunity in the mobility segment.

Also at ITS World Congress last week, IRD launched VI2M, which stands for Vehicle Information in Motion. This is IRD's cloud-based data collection reporting and analysis tool. This product permits user to combine data from multiple sensors, perform a variety of analyses on these data, and prepare a significant number of either prepackaged or customized reports. We think this system is at the centre of IRD's industrial IoT efforts on a go-forward basis.

Finally, we completed a tuck-in acquisition in Q3, acquiring iCOMS Detections S.A., an intelligent transportation systems company based in Brussels, Belgium. iCOMS gives IRD an expanded

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presence in the rapidly growing European ITS or intelligent transportation systems market, and adds new radar-based products and services that we can now offer to all of IRD's global customers.

Looking now at VIZIYA, VIZIYA's Q3 revenues were impacted largely because a few significant licence deals have shifted into the fourth quarter. The typical VIZIYA deal will have a onetime licence fee, annual software support revenue covering a year post the system delivery—and that's renewable annually thereafter—and most often services revenue to assist in software implementation and training.

As a reminder, VIZIYA sells enterprise-grade software to Fortune 1000 companies, operating in asset-heavy industries such as oil and gas, mining, and heavy metals. These sales cycles are long and complex. When we acquired VIZIYA, we accepted that this variability in quarterly performance is a fact in selling to this customer base. Given VIZIYA's size, a shift of a quarter or two for a \$500,000 software licence, for example, can make a difference from a slightly lighter quarter to one that is significant.

Further, we can't lose sight of the acquisition accounting adjustment that saw recurring revenues for the quarter some \$250,000 lighter than would otherwise have been recorded. For fiscal 2018, this deleted deferred revenue adjustment will no longer be required, and we will see an uptick—or really a return to the normal level of recurring maintenance revenue thereafter.

In Q3, VIZIYA signed up its third customer, a large energy services provider, for its cloud data analytics service, which is sold on a software as a service—or SaaS—model. This particular contract is

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for a guaranteed four-year term, which is significant for VIZIYA. In addition, the Company has four other IoT opportunities in the pilot stage. They also signed three smaller licence agreements which have long-term maintenance revenue implications that's adding to the ultimate recurring revenue base.

VIZIYA's pipeline remains strong. To further boost its future activity, VIZIYA hired a Director of Partner Relations in Q3, whose role is to open up sales opportunities through new distribution channels.

With a strong Q3 under our belt and a significant boost to our cash balance post-quarter-end, we have ample capital resources to execute on our growth plan. Our acquisition pipeline is building, and we are currently at various stages of discussion with about a dozen companies. We remain focused on acquiring companies in the IoT market, and in particular, companies in our four segments.

In addition to those target segments, we are looking for businesses that have a broad range of products and services focused on capturing, analyzing and interpreting data, that can turn that data into action-oriented information. We're looking for companies with a history of growing sustainable cash flow; a capable and experienced, growth-oriented management team; an established presence in their business areas with strong customer relationships; a sustainable competitive advantage; and the ability to grow organically or through additional acquisitions.

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We will be continuing—we will continue to be prudent in how we deploy our capital, and are looking for accretive transactions that can generate a 20 percent-plus annual return on invested capital, averaged out over a longer investment hold period.

We remain excited with our growth prospects, and look forward to adding to our portfolio investments in the coming quarters. We are cognizant of rising valuations in the current climate, however, but we continue to remain disciplined in our valuation parameters. When we want to add to our portfolio, we will remain patient in our search.

With that, I'll pass it over to Steve for a more detailed look at the numbers.

**Steve Thompson** — Interim Chief Financial Officer, Quarterhill Inc.

Thank you, Shaun. Good morning, everyone. I'll start off with a look at some of the revenue segmentation in Q3. Beginning with our Q2 release this year, we now break out revenue and cost of revenue by type, licences, systems, services, and recurring. As you would expect, the majority of this quarter's revenue was in the licence category, which includes WiLAN's traditional patent licensing as well as software licence revenue from the factory segment.

Six-point-eight million of revenue was in the systems revenue category, which includes revenue earned on contracted projects, recognized on a percentage-of-completion basis, as well as OEM and proprietary product sales. Recurring revenue as 6.2 million, which includes running royalties from patent licensing, maintenance, software as a service, and data analytics revenue. This revenue tends to come from contracts that range in term from one to five years. Service revenue, which relates

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to professional services-type revenue was nominal in Q3 at just under \$1 million. More detailed descriptions of these revenue types and their related costs can be found in our MD&A.

With Q2, we also began to segment our results by our industrial IoT target markets. As Shaun mentioned, the targeted verticals are technology, mobility, factory, and city. Today we have investments in three of those verticals—technology with WiLAN, mobility with IRD, and factory with VIZIYA. Detailed segmented results on each vertical can be found in our Q3 press release and our MD&A. For the purposes of today's call, focus on highlights from each one, as well as on the consolidated highlights from Quarterhill.

As Shaun mentioned, our consolidated revenue and adjusted EBITDA in Q3 were a record 85.9 million and 60.6 million respectively. Our technology vertical generated 72.6 million in revenues and 61.4 million in adjusted EBITDA. Basically, in one quarter, we delivered adjusted EBITDA in the neighbourhood of what we have been generating on an annual basis over the past few years. It speaks to how performance in the patent licence business needs to be viewed over a longer period of time rather than quarter to quarter.

Our mobility vertical generated 11.6 million in revenues in Q3, and 710,000 in adjusted EBITDA. This vertical is made up of the IRD operations. To Shaun's earlier point, we expect these numbers to improve in coming periods as the new—we expect these numbers to improve in coming periods as new product launches take hold and new sales are generated. Revenue in the factory

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vertical was 1.75 million, with adjusted EBITDA just about breakeven. This vertical is made up of the VIZIYA operations.

Quarterhill's Q3 consolidated net income was 26.2 million, or \$0.22 per basic common share. Included in our bottom line is a 15.2 million noncash expense related to the write-down of an intangible asset. We also had an income tax expense of 9.1 million in Q3, representing a rate of 25.7 percent.

Cash generated from operations was 9.3 million in Q3. Cash flow in Q3 was impacted by the significant increase in accounts receivable in the quarter. Following quarter-end, a significant amount of the receivables were collected, which will have a positive impact on Q4's cash from operations.

In Q3, we also paid 1.1 million in dividends. On the balance sheet, cash and cash equivalents and short-term investments totalled 40.6 million at quarter-end. Per my comment a moment ago regarding collection of receivables post quarter-end, our cash balance at December 31, 2017 should show a significant boost in the level at the end of Q3.

Also on the balance sheet, in conjunction with our patent licence activity in Q3, we have retired the bulk of our patent finance obligation, reducing this liability from 20.6 million to 5.4 million.

This concludes my review of the financial results, and I'll now turn the call back to the Operator for questions.

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## Q&A

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**Operator**

As a reminder, if you would like to ask a question, please press \*, followed by the number 1 on your telephone keypad.

Your first question comes from the line of Doug Taylor with Canaccord Genuity. Please go ahead.

**Doug Taylor** — Canaccord Genuity

Yeah. Thank you. Good morning. Perhaps I'll start with a question. I mean versus your guidance in early October, what was it that would drive such a significant upside versus even those expectations after quarter-end?

**Shaun McEwan**

Good morning, Doug. It's Shaun. The reality is, October 2nd is one day after the year-end for us, basically one day after the end of the quarter, and we've got a fairly big organization now, where historically it was just WiLAN, we were able to pretty well nail the revenue positions almost right out of the gate, very quick. With IRD and VIZIYA, it takes longer to do the accounting rollup, if you will. So it's a combination of all three businesses finally coming together and having some slightly different performance than we expected in our guidance.

**Doug Taylor**

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Okay. On the substantial licence revenue in the quarter, is all the contingent compensation, legal or otherwise, related to those licence wins captured in the quarter? Or do you think there'll be any more that trickles into Q4?

**Steve Thompson**

No. We've accrued after quarter-end for all the contingent consideration related to the deals that were closed within Q3.

**Doug Taylor**

Okay. And then the related cash, I know you said you've collected it. Are you able to provide us kind of a view of—in light of the related compensation you're paying out—related to that, what your cash is on hand now approximately?

**Shaun McEwan**

We're not—it's difficult to give exact numbers in mid-quarter kind of thing, Doug. But the reality is, if you look at the working capital consumption last quarter, it was around \$45 million. You can probably think that that's pretty close to zero now, and that's pretty well added to the cash position.

**Doug Taylor**

Yeah. That's good enough. As you mentioned VIZIYA, IRD, a little bit below your own expectations in the quarter. I understand what's happened here at VIZIYA with some deal slippage. I was just a little unclear on what was going on at IRD. I wonder if you can expand a little on why that

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was below your expectations in the quarter. And I know before, these new product launches happened post quarter-end.

**Shaun McEwan**

Yeah. I think both divisions, as it turns out, were actually pretty significantly impacted by the severe weather patterns in the US. You think of IRD's business being a project-oriented business, massive hurricanes, floodings, all those kinds of things affected their ability to deliver on some of their projects, in particular in some of the lower states, so that was one piece of it. Weather's a big contributor in whether they can carry out their projects or not.

IRD did have at least one if not two fairly significant maintenance contracts renewal-wise slip—we hope they get renewed in the next couple of weeks—but that has an impact on both revenue and bottom line. And I think below expectations on the EBITDA line really is I think our R&D has been pushing a little bit higher than we had expected or hoped in the last couple of months and quarters in fact, really owing to this new product launch and getting it done on time. We think we'll see R&D, certainly after this quarter, kind of return back to a more normalized level, a couple of hundred thousand lighter than it is.

**Doug Taylor**

So just to step back then, the run rate for EBITDA revenue for both divisions, would you expect over the next 12 months for it to approximate what we had expected or what they'd delivered historically?

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**Shaun McEwan**

Certainly that's our goal and expectations.

**Doug Taylor**

Okay. That's helpful. I'll pass the line. Thank you.

**Shaun McEwan**

Thanks.

**Operator**

Your next question comes from the line of Todd Coupland with CIBC. Please go ahead.

**Todd Coupland — CIBC World Markets**

Yeah. Good morning, everyone.

**Shaun McEwan**

Good morning, Todd.

**Todd Coupland**

Could you—you mentioned the higher—just on the slippage of the two IoT businesses, could you just give us a rough idea on how much revenue and EBITDA was affected in both IRD and VIZIYA in the quarter?

**Shaun McEwan**

Sorry. I've got something in my throat. In VIZIYA, it's probably a little easier to identify because there's a few contracts. A software-related contract, as I said, it might not—it's \$500,000

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software licence which would normally have some maintenance revenue and some services revenue applied to it, when it slips from Q3 into Q4, that's \$500,000 of revenue and fundamentally \$500,000 of EBITDA. We had at least one of those deals in the VIZIYA instance and there's a few others that are smaller in magnitude, but because they're software licences they have a very dramatic impact on the EBITDA line.

In IRD's case, it's a little harder to talk about. Their margins tend to be in the 30 to 35 percent range, so to the extent that we missed about 1 million, \$1.5 million of revenue that we expected, it's probably 300,000 to \$400,000 worth of EBITDA contribution that we would have missed. But don't try to take that as guidance because it's a function of the—in IRD's case, it's a function of how they can roll the projects out. And when you're looking at weather and weather dependencies, it's not that it just slipped; it's difficult to hit the delivery on the project itself.

### **Todd Coupland**

And the seasonality in IRD, what kind of rhythm should we see in that business?

### **Shaun McEwan**

Again, we have to go back to looking at IRD's previous financial statements prior to joining the Quarterhill family, but their Q4 and Q1 now will likely be on average a little lighter than Q2 and 3, generally. Because if you—again, it's mostly weather-based. In Canada and the northern half of the US, winter months start to make it more difficult to achieve some of their projects. We are looking to

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their South American operations, in particular out of Chile, to pick up some of that slack. But Chile, frankly, is a little behind time right now as well.

**Todd Coupland**

Okay. No. That's helpful colour. And then just on the WiLAN piece. So for the licences that would've been signed in Q3—Samsung, Motorola, and you mentioned I think a couple of others—has that now all been recognized in the financial statements? Or are there follow-on and/or recurring pieces?

**Steve Thompson**

No. They would have been all reflected in the financial statements.

**Todd Coupland**

Okay. And then once you get the \$45 million in cash, you essentially will have sort of caught up from all of the payments relating to those agreements as well?

**Shaun McEwan**

Correct.

**Todd Coupland**

Okay. And then just lastly, you talked about the pipeline of patent licensing being pretty robust. Can you characterize it let's say versus this very good quarter? Would you—like are you on a bit of a run, so it should continue to be a tailwind in the fourth quarter? Or should we—should we expect a bit of a lull now that you signed all these deals in Q3?

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**Shaun McEwan**

I'm kind of chuckling, Todd. It's a good kind of question, I guess, and I think we can see the results of the variability over the last five or six quarters. A 30, an 8, a 72—it's difficult to predict exactly when a licence is going to sign. We can tell you that we remain very confident that we've got substantial irons in the fire, if you will. We've got a number of litigations coming to—fundamentally to trial in the next 12 to 16 months. There's all the reason to believe that there's ample opportunity to continue to have significant performance as we have in this quarter. But is it going to be in Q4 or Q1, Q2, 3 next year? It's very, very, very difficult to predict that.

**Todd Coupland**

And then just lastly on M&A, you talked about an active pipeline. Have you done the digestion necessary on VIZIYA and IRD so you're in a position to act now if you want to?

**Shaun McEwan**

If we put it on a—I think we are in a position to act for sure if we had the right kind valuation, the right kind of deal parameters on the other side. As I said in the prepared remarks, we're seeing valuations still remain or even increase in terms of loftiness; that's making it a little more difficult for us to stick to our guns, but we're remaining patient in that exercise as well. Have we completely digested IRD and VIZIYA? We have work to do, there's no doubt about that. If I said it was probably 60 percent digested versus 100, it's probably more like 60.

**Todd Coupland**

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What are the kinds of things that you're working on in those two areas?

**Shaun McEwan**

Just generally getting the reporting, the forecasting, the business discipline structure in, trying to shift the business into the three divisions that we have or three subsidiaries that we have, that kind of stuff. There's a little bit of synergies that we think we can strip out relative to back office administration-type operations, which will take us a bit of time to work through.

**Todd Coupland**

That's great. Thanks very much. Appreciate the colour.

**Shaun McEwan**

Thank you.

**Operator**

As a reminder, to ask a question, please press \*, 1 on your telephone keypad.

Your next question comes from the line of Rob Peters with Cormark Securities. Please go ahead.

**Rob Peters — Cormark Securities**

Hi. Thanks for taking my question. I think a good amount of them have been answered. But Shaun, just when we talk—when we look at the patent portfolio you acquired post the quarter, and I know you announced that you also had one done under your partner program in the quarter, how should we kind of think about investing in patents going forward at WiLAN, and kind of the weighting

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between the partnership program or the buying outright? I assume it's still kind of weighted much more towards the partnership programs?

**Shaun McEwan**

That's a correct assumption, I think. The business has the intention to try to do everything as much as possible into the partner program. And even then, some of the partner programs may still have a small amount—\$100,000 or something like that—in an up-front payment to make it palatable to the partner to carry the transaction. So again, capital—CapEx on it is fairly small on an annual basis, but there may be a few dollars even in the partner program from a CapEx perspective.

**Rob Peters**

Perfect. Thank you very much. And then looking at IRD, obviously, I think it's good colour on the weather impact there. I know you said that their Q4 and Q1 tend to be a bit lighter. Is there any chance to see some catch-up in Q4, just given I assume some of those projects have been delayed in the quarter?

**Shaun McEwan**

We're looking for some catch-up, although again, it depends on our ability to deliver on the project itself. Currently our forecasts say that it's a bit of catch-up but not material.

**Rob Peters**

Okay. Perfect. And then just one last question from me. I was just hoping; do you have any update on when we can look forward to hopefully taking the Interim off your name?

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**Shaun McEwan**

The process is ongoing still. The board is obviously being very thorough and diligent in its search, and you can't really predict timing. The board will make its decision when it determines that it's completed the process. So at this time, I can tell you the process is still ongoing and the board's very diligent.

**Rob Peters**

Perfect. Thank you very much.

**Operator**

As we have no further questions at this time, this concludes Quarterhill's Q3 2017 financial results conference call. You may now disconnect your line. Thank you.

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