FINAL TRANSCRIPT

Quarterhill Inc.

Third Quarter 2018 Financial Results Conference Call

Event Date/Time: November 8, 2018 — 10:00 a.m. E.T.

Length: 43 minutes

CORPORATE PARTICIPANTS

Doug Parker
Quarterhill Inc. — President and Chief Executive Officer

Shaun McEwan
Quarterhill Inc. — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Doug Taylor
Canaccord Genuity — Analyst

Gavin Fairweather
Cormark — Analyst

Todd Coupland
CIBC — Analyst

PRESENTATION

Operator

Good morning, and welcome to Quarterhill's third quarter 2018 financial results conference call.

On this morning's call, we have Doug Parker, Quarterhill's President and Chief Executive Officer; and Shaun McEwan, Quarterhill's Chief Financial Officer.

At this time, all participants are in listen-only mode. Following 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 three and nine months ending September 30, 2018. This news release, along with the Company's MD&A financial statements, will be available on Quarterhill's website and will be filed on SEDAR and EDGAR.

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 could affect results, and 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 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 is in US dollars, unless otherwise specified.

I would now like to turn the meeting over to Mr. Parker.

Please go ahead, sir.

Doug Parker — President and Chief Executive Officer, Quarterhill Inc.

Good morning, everyone, and thank you for joining us on today's call. I'll start things off with an overview of our businesses in Q3, followed by some comments on our M&A-related activity. Shaun will then take a more detailed look at some of the key numbers, and then we'll open it up to questions.

For Q3, revenue was 19.6 million, of which 32 percent was recurring revenue. Adjusted EBITDA was negative 2.5 million, and we ended the quarter with cash and equivalents of 62.4 million.

At a high level, revenue was down slightly compared sequentially to Q2 2018, and adjusted EBITDA improved notably from the Q2 level. Adjusted EBITDA improved due in large part to continued solid performance from IRD and VIZIYA, and in particular in Q3 with IRD.

On the M&A front, we made some good progress in the quarter, which I'll get to in a moment, but first I'll spend a few minutes on each of the businesses highlighting some recent developments.

Q3 is the first quarter this year where the comparison period in 2017 is one in which we had owned both IRD and VIZIYA for the full period. If we look at these businesses today compared to where they were last year, we see some positive results.

In Q3, the two businesses generated 15.1 million in revenue, which was up 14 percent from Q3 last year. The two businesses generated 1.6 million of adjusted EBITDA, which was up more than 100 percent from Q3 last year. On a trailing 12-month basis, IRD and VIZIYA combined have generated 56 million in revenue and 5.7 million of adjusted EBITDA for Quarterhill.

These two businesses have brought scale to the Quarterhill business, and have done so on a profitable basis. We think that these businesses have the potential to build on this performance, and deliver enhanced results in coming quarters and years.

Looking first at IRD following a strong Q2, IRD again had a good quarter in Q3 at both the revenue and adjusted EBITDA level. Q2 and Q3 tend to be seasonally stronger quarters for IRD, and they've executed well on their opportunities during this period.

One of the key achievements in the quarter was the signing of a new five-year 8.1 million contract with the State of Hawaii following expiry of our existing contract with them earlier this year. IRD is providing the state with its continuous traffic monitoring system. The agreement includes IRD's Vehicle Information in Motion, VI2M, cloud-based data collection, reporting, and analytic service, which is a relatively new product on the market and one we're excited about.

Vehicle Information in Motion allows users to combine data with multiple sensors, perform a variety of analysis of this data, and prepare a number of prepackaged or customized reports. In the case of Hawaii, it will provide the state with a complete picture of activity across all 81 traffic monitoring sites. And this data will be used as a means for monitoring road wear and tear, providing estimates for noise studies and identifying changes in highway travel patterns, among other things.

Other notable activity for IRD in Q3 included a 10-year service contract with the State of Virginia for 4.2 million and an agreement in Thailand for four mainline sorter systems and spares worth 1.2 million.

We think the outlook for IRD is promising, both in North America and internationally. I'm especially encouraged by the level of customer interest in the new VectorSense TACS in the tire safety enforcement marketplace. Based on statistics published by the US Federal Motor Carrier Safety Administration, tire out-of-service violations are almost as much of a safety problem in the trucking industry as are brake issues.

IRD has a unique market opportunity with technology that can screen for tire anomalies at mainline and ramp speeds, and already has seven TACS projects lined up for fiscal 2019.

As part of my ongoing commitment to work with our portfolio of companies to help them optimize their operational and financial performance, we took some action in Q3 to fine-tune the leadership, operational structure, and growth strategy at IRD. And we think this has the Company well positioned to deliver a higher rate of business going forward. Shaun will discuss the financial impact of these changes in his section.

VIZIYA's results in Q3 reflect some of the lumpiness you can see in software licence sales, and the impact that one or two large contracts can have when pushed into a subsequent quarter. Among Q3 highlights, we continued to see traction with the Company's SaaS model sales based on its partnership with Oracle.

It completed development and delivered a new version of its analytics product supporting Oracle JD Edwards to SaskEnergy, which begins a five-year cloud service deployment with that client. In addition, VIZIYA's global consulting division completed go live of Oracle's cloud maintenance product at The Wonderful Company, which is the world's largest grower of tree nuts and America's largest citrus grower, among other things.

This is the world's first production deployment of this new Oracle product, and VIZIYA played a key role in getting it operational.

Looking at VIZIYA's results overall, importantly, even in a softer quarter, the Company still generated positive adjusted EBITDA on revenues that, while lower than Q2 of this year, were more than 50 percent above from last quarter in Q3—from Q3 last year, pardon me.

Its pipeline continues to build, and a few deals in the quarter that were expected to close were pushed out into future periods. We expect them to close down the road, so they were not lost deals as such.

Overall, VIZIYA is in the category of verticalized software firms that we like, and we remain impressed with both the leadership of the business, as well as its potential for scalability and profitable growth.

With WiLAN, the key news in the quarter was the trial verdict rendered on August 1st in the US District Court for the Southern District of California, where a jury awarded WiLAN $145.1 million in damages against Apple for infringement of two patents related to cellphone technology. In addition to the monetary damages, this result reflects well on our team, our patents, and our process and enhances our profile in the industry.

Q3 was also Keaton Parekh's first full quarter as CEO of WiLAN, and I've been very impressed with his level of engagement with the team and his strategic perspective on the business. The patent licence market remains a challenging place, but I have the utmost confidence that Keaton has the skills, global perspective, and proven track record to drive WiLAN forward to its next phase of evolution and success.

Results for WiLAN in Q3 again reflect the variability we've spoken about in the past. But as evidenced by the verdict against Apple, the business is still capable of delivering significant awards and potentially large cash flows.

With respect to the Apple verdict, the next step is the post-trial briefing process, which will take place in November, and we anticipate the trial judgment will be entered by the court in early January, if not sooner. And thereafter, Apple may file a form of appeal.

We anticipate that any appeal process would take approximately 12 to 18 months. Nevertheless, should they appeal, we're confident in our position and have the resources, experience, and perseverance to see the process through until the end.

On the M&A front, we continued to see progress in building out our pipeline, and we have a series of late-stage negotiations underway right now. In terms of specific deal opportunity metrics, in Q3 we had a strong deal flow in our strategic focus area receiving and reviewing 27 teasers, roughly one every few business days, and entered into six NDAs to assess acquisition targets.

In closing, we have an M&A deal team with the right skills and experience that has built a solid pipeline of opportunities of which we are actively engaged on a select few that meet our strict criteria.

We're also working hard to ensure that the companies we own are operating as effectively as possible, and that they're getting the support needed to generate the growth, profitability, and cash flow streams that we believe they can deliver and that we rely on to execute our diversification strategy.

With that, I'll pass it over to Shaun for a closer look at the numbers.

Shaun McEwan — Chief Financial Officer, Quarterhill Inc.

Thanks, Doug, and good morning, everyone. I'll start off with a look at Q3 revenue in a little more detail.

As Doug mentioned earlier, Q3 was the first quarter where the comparison period in 2017 included a full period of results from both IRD and VIZIYA. Q3 revenue was 19.6 million, which was down a few percentage points sequentially from Q2 of this year. Revenue was down year over year, as Q3 2017 included a blockbuster quarter from WiLAN, generating 72.6 million in revenue from that business in that period.

The year-over-year change in WiLAN revenue is a clear indication of the variability in that business.

In looking at revenues and expenses in Q3, a sequential comparison to Q2 2018 is much more apples-to-apples, if you will, for the consolidated Quarterhill business than a year-over-year, given WiLAN's outsized Q3 2017 performance that I just mentioned.

On a segment basis, revenue in the licence category, which includes contributions from WiLAN and VIZIYA, represented 24 percent of total revenue compared to 28 percent in Q2 this year and 84 percent in Q3 of last year, which again was due to the large contribution from WiLAN. Year to date, licence revenue was 24 percent of total revenue.

Systems revenue, which generally includes revenue earned on contracted projects and recognized on a percentage of completion basis, more or less, was 40 percent of total revenue in Q3 compared to 35 percent in Q2, with a sequential uptick reflecting good performance in the IRD business, as Doug has mentioned.

Driven by IRD and VIZIYA's results, recurring revenue was 32 percent of total revenue in Q3 compared to 34 percent in Q2. This is a component of revenues we have mentioned that we are looking to grow over time as we acquire businesses with good recurring revenue sources.

And finally, services revenue, which relates to professional services-type revenue, was again nominal in Q3 at about 3 percent of total revenue.

For IRD and VIZIYA together, they combined to generate 15.1 million of revenue, or 77 percent of total revenue for Q3. And year to date, the two generated 41.8 million, or 80 percent of total revenue. The two generated 16.2 million in Q2 2018 and 13.3 million in Q3 of 2017. For Q3 2018, gross margin increased to 26 percent compared to 19 percent in the previous quarter, based largely on lower cost of revenues.

Operating expenses were slightly lower in Q3 2018 compared to Q2, primarily due to lower SG&A. Of note, in Q3 of 2018 was a $2.3 million onetime expense related to the organizational changes made at IRD that Doug mentioned earlier. As a reminder, these changes are expected to save IRD $2.2 million annually going forward.

Adjusted EBITDA in the quarter was negative 2.5 million, which was an improvement from the negative 4 million in Q2. The sequential improvement was primarily due to lower cost of revenues and lower SG&A quarter over quarter.

In Q3, IRD and VIZIYA generated positive adjusted EBITDA with margins of 12 percent and 6 percent, respectively, compared to margins of 6 percent and virtually 0 percent in Q3 last year. On a year-to-date basis, IRD and VIZIYA combined have generated 4 million of adjusted EBITDA.

Cash used in operations was 9 million in Q3 compared to cash used in operations of 2.4 million in Q2. Cash flow in Q3 2018 and for the year-to-date period primarily reflects the impact of the variability in the financial performance of the WiLAN business.

On that note, I do want to remind listeners that WiLAN, since reforming as a patent licensing company slightly more than 10 years ago, has generated more than 850 million in revenue and more than 400 million in adjusted EBITDA. That’s a track record that a vast majority of companies would be seriously envious of.

So while there is some enhanced volatility recently, the long-term view, as we’ve always maintained, is crucial in evaluating the overall performance of this business.

On the balance sheet, cash, cash equivalents, and short-term investments, including restricted investments, totalled 62.4 million at the end of Q3 compared to 86.6 million at the end of 2017. The total at the end of Q3 represent substantial cash on the balance sheet to continue to pursue our M&A strategy. And as Doug mentioned earlier, we continue to work closely with each of our portfolio businesses to help them create the conditions where they can optimize growth while delivering steady cash flows.

With its $145 million trial victory against Apple in the quarter, and with its significant revenue generated last year in Q3, WiLAN has demonstrated clearly that while there is some quarterly variability in its numbers, it has the ability to generate large cash inflows that more than make up for periods where it consumes cash.

In terms of capital allocation, our focus remains on deploying the cash to acquire other portfolio businesses and on our dividend. We believe this remains the best use of funds for building long-term value in the business.

Finally, on that note, this morning in our earnings release we announced details of our next dividend payment. The Board of Directors has declared an eligible dividend of C$0.0125 per share payable on January 9, 2019, for shareholders of record on December 14, 2018.

With the payment of that dividend, Quarterhill and its predecessor company, WiLAN, will have returned to shareholders more than 136 million through dividends and share buybacks.

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

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question, please press *, then the number 1 on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

Your first question comes from Doug Taylor from Canaccord Genuity. Your line is open.

Doug Taylor — Canaccord Genuity

Thank you. Good morning, Doug and Shaun—

Doug Parker

Morning, Doug.

Shaun McEwan

Morning, Doug

Doug Taylor

—by asking a little bit about the M&A funnel. You spoke to the number of opportunities with respect to teasers and NDAs that you signed as you're looking through for your first acquisition there at the helm, Doug. How do you view the valuation expectations? Have they changed appreciably, given the volatility that we've seen in the public market in the last couple months?

Doug Parker

Yeah. It's a good question. Thanks, Doug, for that. I mean, I think you have … you've definitely seen a little bit more of a frothy market in, say, in the last 12 months in M&A in general. I think valuation expectations are on the high side of the cycle. Interestingly enough, in certainly some of the active processes we're in now, we are seeing a little bit of the sheen coming off on that. And I think for me, certainly we're seeing deals that are out there that are in our sweet spot in valuation side.

To be frank, though, it does take a little bit longer for those processes to unfold. We are seeing opportunities, for example, where the valuation expectations are extremely high, processes have gone through, and people have hesitated and not proceeded at high values. And those sort of boomerang deals where there's kind of an expectation, a more reasonable view on valuations, particularly in the private company side where we're engaged in further dialogue after an initial process hasn't gone through, is a trend we're actually seeing in increasing velocity.

So I'm confident the deals are out there in the sweet spot and we can get the valuation we want, even though in fairness the last 12 months have been from a valuation perspective higher. But we are seeing a traction on the boomerang deal side, and also a little bit of softening of expectation.

So I think that for sort of I look ahead for the next year, I think the trend in the market is in favour of kind of where we play. But it certainly does take a little bit longer to land those type of deals.

Doug Taylor

Would you say that valuation has been the biggest source of hesitation for you in pulling your trigger on a first transaction? Or is there some fit issues that you haven't … nothing hasn't quite fit your expectations? How would you describe it?

Doug Parker

Yes. Yeah. So I think—I get that question a lot, and it's a good question, Doug, is I think it's a combination of things. There have been processes we're in where we just haven't been prepared to play at the valuation expectation levels. And so there's I would roughly say probably maybe a third of our current pipeline is in that world.

Because of our model, we also spend a significant amount of time assessing the expectations of management. Our integration model's very focused on management committing to a long-term vision with us because obviously you want a lot of ongoing independence. And because we're not strictly based on a cost synergy horizontal play, we have a lot of circumstances where we have to be comfortable that management wants not just a three to five year clip; they want to stay on and continue the journey with us.

And so I would say about a third of the opportunities we've been competitive on price but we've been quite concerned about the management dynamic, and have actually pulled out of processes on that. And then a third, I would say, are circumstances where the processes themselves have kind of … have stalled and we're kind of actively involved in them, but we don't … we haven't done enough diligence yet to make the determination on the people side, although we think ultimately the valuations are going to be coming down.

So the long and short of it is it's not that we haven't pulled the trigger because when we look at our playbook we're seeing us always being in a situation where we can't meet on valuation. It's been a combination of valuation, but equally as important, as we look at the management dynamic and making sure we have the right people who can run the businesses that partnership with us after we buy.

Doug Taylor

Okay. Shifting gears to the WiLAN business, I guess we'll wait and see for the Apple award what the path forward is there. But there have been some discussion previously about that announcement and that jury decision potentially having a knock-on effect on your ability to monetize your patents within that industry with other players. Have you seen that flow through into the pipeline or the activity levels for the wireless patents specifically? Has that actually happened?

Doug Parker

Yeah. I mean, I think we certainly are … we're already currently in litigation, for example, with LG in the US with patents in the same family. We've got also litigation with LG in Germany and Canada as well. So those patents are already kind of we're actively using those patents and families of patents in existing litigation.

I would put it this way. I'm not sure it necessarily immediately results in an ability to find new people that you feel you want to monetize your IP with, but it certainly increased and expanded the street cred that WiLAN has in licensing in general because I think an ability to take Apple to the mat, obviously that's not our goal is litigation for us, we prefer to avoid that route, but when we have to do it, we do it. But to take over a three- to four-year period to take Apple in their backyard on the same day they were declared a $1 trillion company, get every single dollar on a jury trial you asked for, has improved our general level of credibility. And that—immediately does that result in an ability to go hunting elsewhere? Maybe.

But it certainly increases the overall level of engagement at the partner level, and also it helps strengthen our existing cases where we're using those patents against other parties, such as LG.

Doug Taylor

Okay. Last question for me. The IRD restructuring and the costs that you took in the quarter, is the benefit baked into the Q3 results? Or would you say that's going to be incremental to where the operating costs and gross margin levels were in Q3?

Shaun McEwan

It's Shaun here, Doug. The restructuring happens sort of mid-July, the end of July, so it's kind of baked in for at least two to three months, but not all of it.

Doug Taylor

Okay. I will pass line. Thanks.

Doug Parker

Thanks, Doug.

Operator

Your next question comes from Gavin Fairweather from Cormark. Your line is open.

Gavin Fairweather — Cormark

Hey, there. Good morning.

Shaun McEwan

Morning Gavin.

Doug Parker

Morning.

Gavin Fairweather

Just wanted to start out on the IRD side, you mentioned the new contract there in Hawaii. Curious if you could just kind of walk us through the contract value of the new contract that had the Vehicle in Motion component to it compared to the old one, just trying to think about the upsell that happened there?

Doug Parker

Well, as I said in my script, it's 8.4 million over the period of time. It's effectively the same … the maintenance contract's on the same terms. Typically those are relatively even over … historically over the history per year of the contract, although there tends to be a little bit of an uptick on some of the revenue at the beginning, and sometimes you see an uptick of the revenues in the last year as well.

The incremental products right now, as I said in the script, we're adding a relatively modest uptick opportunity in the overall value to the new VI2M product. Our hope over time is—TACS is not included, Gavin, in that—but our hope over time that we can make a use case to have TACS incrementally added to that.

And that's certainly been attractive because TACS is a product that has much higher margins. I mean, stand-alone the margins are well north of 30 percent of the product and it's often bundled.

The margins are slightly less, but it's a very attractive product, particularly in the US. Internationally, it's used more in the tolling side, and I think there's opportunity there.

So it's a relatively—I think the way to look at it is it's the same—it's a renewal of the existing contract, but there's new product overlay, which is relatively modest for now but an opportunity to add—expand that offering over time to improve the overall mix of margin. That's how I look at it.

We have a very strong relationship with the State of Hawaii. They're very innovative, and very interested in our kind of new suite of products that are more higher gross margin and go up the value chain and ITS. And they've been really supportive and very open minded to those opportunities, and that's why I think it's a really good contract from that perspective, over and above the, once again, an example of where IRD has a very sticky customer base where it's able to get renewals, multiyear renewals in a government procurement environment, which it's just got a high level of stickiness I find attractive.

Gavin Fairweather

Okay. That's quite helpful. And then on VIZIYA, it sounds like there's been a slippage kind of in the quarter in terms of some licence deals maybe falling into future quarters. Was it a number that you would call out as being kind of meaningful? Maybe you could just share some light on that and whether you'd expect kind of a catch-up in future quarters?

Doug Parker

Yeah. I think … so when you're talking about the slippage, when I look at the VIZIYA business, it has sort of a steady-state business of smaller opportunities that are there and that they've had success on in the perpetual licence area. But they're kind of at a tipping point where they get into sort of they matriculate into the much larger multimillion-dollar licence opportunities. And they are pursuing some of those. I'm not at liberty to talk of the specifics. But they're getting very far in those processes, and are definitely—there is an embedded option where their business can grow in a meaningful way through that.

And some of that's driven by existing strength of their relationship, particularly with SAP, but some of that is just, particularly on their scheduling side, that the level of functionality that is very much driven.

So the extent to which you get an enterprise-wide licence opportunity, that's where you're going to get, pick company X, you're going to get an enterprise-wide licence opportunity versus individual licences with sites. That's where you're going to get multimillion-dollar licence opportunities. And they're pursuing both. They're pursuing the ordinary course, smaller site-specific perpetual software licence opportunities, but they're also now participating in RFP processes for the enterprise-wide opportunities.

And I kind of see it as a matter of time before they land one of those. And that will be a material increase in revenue for their business, but also credibility with them to get more opportunities to leverage that kind of expertise. And once you get into that area, it often tends to—once they're successful with one customer, there's often a pile-in effect as well—

Gavin Fairweather

That's quite interesting. Does it change kind of the competitive dynamics on who they're going up against for those larger deals?

Doug Parker

I'm not sure. I mean, I'm not sure it does. I think VIZIYA for a relatively modest company has an incredibly strong reputation from a technical perspective, and also they're seen as extremely customer-focused. So I don't think from a competitive dynamic there'll be a shift where they—where there's a change in the marketplace.

I think what you are seeing, though, is a centralized … I think you're seeing more centralized buying or centralized procurement where some of the companies are trying to centralize the decision-making, or trying to get results in those enterprise licences versus resulting in individual licences at the site. Although one of the things in the dynamic is often there's a lot of economy that's given to the sites because of the technical nature. If you're running an oil and gas plant or a mining site, often the level of autonomy that's given to the local management team over their purchasing decision from software is much greater than you would see in a lot of traditional businesses.

So there's still very much a business case and a market dynamic where there's an opportunity to sell perpetual software licences one-off to these individual sites.

So you're seeing two things in the market. You're seeing a relative level of stubbornness because of the nature of autonomy that these sites have, but you're also seeing a general push at the same time and an attempt in certain industries and certain companies specifically to try to result in an enterprise licence approach.

So you're seeing a bit of both at the same time.

Gavin Fairweather

Okay. That's it for me. Thank you so much.

Doug Parker

Thanks again.

Operator

Your next question comes from Todd Coupland from CIBC. Please go ahead.

Todd Coupland — CIBC

Yeah. Good morning, everyone.

Shaun McEwan

Good morning, Doug (sic) [Todd].

Todd Coupland

A couple questions; I'll start with IRD. So you've obviously done well the last couple of quarters citing contracts and seasonality. How should we think about Q4 seasonality for IRD?

Doug Parker

Yeah. I mean, IRD historically Q4 is a little bit softer when you compare it to Q2 and Q3. The drivers in that, particularly on the US marketplace, is often a product of weather and just the kind of installation side on some of the larger contracts. So I do envision it potentially being a softer quarter. But one of the things that we've been impressed with is the level of building of the pipeline in general, both internationally and in the United States.

So I would say the pipeline from my perspective is as strong as it's been in the last couple years, frankly. So we're fairly confident that although it historically is a softer Q4 that there's going to be enough revenue and certainly the focus on the adjusted EBITDA for us to see it as being as good a Q4 as reasonably you can expect with the natural seasonality in the business.

Shaun, do you have any more comments or perspective on that one?

Shaun McEwan

The only thing I would throw out is historically, and again it's in particular the comments you just made, Doug, in terms of the pipeline and the volume of opportunities and the fact that it's getting to mid-November, we're not really in full-time winter helps obviously as well—

Doug Parker

Yeah. In North America.

Shaun McEwan

—relative to that seasonality kind of an issue. But historically quarter—or IRD's Q4 revenues are probably in the 22 to 25 percent of their annual business, whereas Q2 and 3 is sort of in the 30 to 32 percent range kind of thing.

Doug Parker

Yeah.

Shaun McEwan

So again, without trying to get into specific guidance and forecast kind of stuff, that's at least been the historical perspective.

Todd Coupland

Okay. And as you think about both VIZIYA and IRD not quarter to quarter, but run rate putting—smoothing out lumpiness for licences, et cetera, what's a reasonable organic growth rate for those businesses? Is it mid-single digits? Is it low-double digits? How are you thinking about it?

Doug Parker

Yeah. It's a good question. I mean, we look at it this way. I think what you would expect from VIZIYA as they continue to make their progress is sort of north of 10 percent growth rate in a successful growing SaaS with licence-based enterprise software companies. So that one we think there's meaningful upside kind of north of 10 percent or more.

Some of that will be driven by their ability to get these larger enterprise contracts, Todd, and some of it'll be driven by their ability to have partnerships—to keep—to maintain strong partnerships specifically with Oracle and SAP. So we'd expect a successful growing—I don't think it's 100 percent a year every year over year that you see in kind of the one or two darlings in the software or the SaaS space, but it's a successfully growing profitable north of … well north of 10 percent being kind of how I see it if it continues to deliver.

IRD, though, is a different creature. IRD has, as you know, a big hardware component. They're trying to go up the value chain and intelligently adding that software mix. But the nature of their kind of government contracts, it's sort of a GDP … you can expect the GDP-level growth, so mid-level single digits is realistic.

Certainly, we're focused as well not only on that growth, but trying to improve that gross margin. And it's holding at the 30 percent level. As they add the tax on, we expect some relative increase in that gross margin. But it's a multiyear evolution. So I think realistically that's how we look at it.

Shaun, do you have any other perspective on it?

Shaun McEwan

No, I think that's fair.

Doug Parker

Yeah. Okay.

Todd Coupland

No, that's super helpful. And you've done of a little bit of rightsizing of the businesses since you've come onboard. It sounds like that's the fine-tuning that you're at least going to do for now with this kind of growth framework going into 2019. Is that the right way to think about that?

Doug Parker

Yeah. Yeah. It's a good question. I—yes, that's the right way of looking at it. But my perspective on is we're always looking at a way of improving operational efficiencies of all of our businesses. And so I always a watching brief on the kind of the OpEx of the businesses versus the upside return. And so right now we … when we look at our businesses, we have a watching brief on all of them.

Certainly I think with IRD it was very important, I felt very strongly we needed to—that there was some low-hanging fruit there and to have enough money to invest in the development side. We did not enter restructuring at all touch the development and the R&D side because we recognized that's important to the future of the Company. And to the—the management team was very supportive of that.

But we're … our model is very much focused on always watching intelligent growth, and that intelligent growth means we'll always have a watching brief on the OpEx mix and the net revenue abilities of our businesses to generate over time. So we're very focused on cash and cash flow; applies to all of our businesses.

And right now, it's particularly IRD we had to make some moves there. But from my perspective, I think that's where we stand on it right now. But we'll always look at a way of making our businesses more efficient and generating more free cash flow where possible.

Todd Coupland

And just one more on VIZIYA. So I think they're in Hamilton, if I'm not mistaken, the staff.

Doug Parker

They are. They are, yeah.

Todd Coupland

And obviously the tech corridor is robust. What has the staff turnover been like since Quarterhill acquired them? And is … what's the mind-set of the staff there, et cetera? Are people energized? Just a little bit of colour on that, given the competitive tech environment for good programmers, et cetera.

Doug Parker

Yeah. It's a really good question. And when I came onboard, it was one of the first things I looked at, Todd. They've had very little attrition, very little attrition. The entire senior management team is there. They're able to attract from a lifestyle perspective a lot of developers who are a little bit—like living a little bit out on that area. You've got a very strong high-performance management team. So the amount of attrition is as on the low end I've ever seen in an acquisition scenario.

There are probably some investments that need to be made in the future in their organization as they sort of build out their SaaS opportunity. And they're going to have to—there are some investments we're going to have to look through in partnership with the VIZIYA management team, and there's going to be some sort of inevitable ramping up on the development side for SaaS. But—and there also will be probably some investment on the sales organization, as you'd expect.

But the level of attrition, both at IRD and VIZIYA, has been very much on the low end side. Often you'll see 5 to 10 percent attrition in an acquisition scenario, or even more. We're looking at lower levels than that in both businesses.

Todd Coupland

So with a good management team and a focus on SaaS, does it impact your thinking on acquisitions? So for example, does the sales team there, could they sell another SaaS product that maybe doesn't have a very good front end? And—

Doug Parker

Yeah. It's a good question, yeah.

Todd Coupland

—your M&A thinking?

Doug Parker

It does, it does—

Todd Coupland

—business?

Doug Parker

No, it's relevant. I mean, there's absolutely it goes into when we're looking at the management team, it's always easier, as you know, to buy an acquisition, to have a business, and to do M&A with an existing management team that has the skills to integrate and participate in it.

So from my perspective, I see a lot of opportunity in ITS from acquisitions. I see a lot of opportunity in enterprise asset management. And frankly, I see the IRD and the VIZIYA management teams as effectively part of our M&A organization. And they're very receptive to it.

It's an attractive aspect when you sell the Quarterhill vision to management in smaller organizations. They really want to see this as an access for capital. We obviously have Quarterhill's senior team that's brought and integrated businesses, but I see that as a positive aspect. And so I think talking very candidly with the leadership of IRD and VIZIYA, they're extremely excited about that opportunity.

And they have been actively involved in some of the opportunities we've looked at already. So it's very much a positive aspect. And I cherish it because it will always be easier to integrate a business when you have a management team that really is supporting other—and have equal ownership as corporate does.

Todd Coupland

Okay. No, that's helpful. A last question for me. So when I think about patent licensing, it's obviously lumpy, so we understand that. But there's a large unlicensed portion of your various programs. How deep are your discussions and pipeline as you think about the next few quarters? Is it going to be fairly scarce? Or do you feel like you'll see some … still see some big ups and downs; we're not going to have to wait for quarters for it to work out?

Doug Parker

Well, I think so …. maybe the way to look at it is it's always difficult … just the nature of it it's always difficult to make that kind of prediction, as you know, and you obviously followed the Company and seen that. I think the way I look at it is the level of cadence that we're seeing with our partners and frankly the litigation, the kind of scale of litigation we have, is the same; I've see no measurable change in that since I've joined as CEO.

For example, we do have a number of current litigations ongoing. And in '19 we've got a couple in the spring, a couple in the summer. For example, April 2019 we've got one with Sharp and VIZIYA regarding our TV portfolio; in July, we've got one coming out with OmniVision in Delaware regarding CMSO lighting, et cetera, so—imaging, rather. We've seen sort of the cadence not really change in any material way.

Is the practicality of … I often get the question is there a fundamental change in the future legislative environment in the United States what will impact, will either create headwinds or tailwinds? And I think we're planning for the assumption that the current environment is what it is.

And certainly an Apple-type win, as I've said, gives us a lot of interest on the partner side. We also have a new leader who's very strong, Tessera background, et cetera, of getting value and building partnership opportunities. And he needs time to put his stamp on the business, which he will. He's a very strong leader in California, where a lot of the action happens in the semiconductor and in other areas.

So I see more of the same from opportunity perspective. But I do think that an Apple-type victory really does just give you a lot of credentials when you're talking to third parties; that is helpful. But I've seen no drop-off in the cadence of partnership or litigation. So I think it's more of the same, Todd.

Todd Coupland

That's great. I appreciate the colour, guys.

Shaun McEwan

Thank you.

Doug Parker

Thank you for your time.

Operator

As there are no further questions at this time, this concludes Quarterhill's Q3 2018 financial results conference call.

You may now disconnect your line. Thank you.

*****