

Microsoft Nokia Transaction Conference Call

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Edited into an e-book format with slides inserted by Sándor Nacsa

My own analysis:

UNIQUE NOKIA ASSETS (FROM FACTORIES TO GLOBAL DEVICE DISTRIBUTION & SALES, AND THE ASHA SUB \$100 SMARTPHONE PLATFORM ETC.) WILL NOW EMPOWER THE ONE MICROSOFT DEVICES AND SERVICES STRATEGY

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Sources: [TRANSCRIPT OF MICROSOFT NOKIA TRANSACTION CONFERENCE CALL: STEVE BALLMER, STEPHEN ELOP, BRAD SMITH, TERRY MYERSON, AMY HOOD; SEPTEMBER 3, 2013](#) + [MICROSOFT'S STRATEGIC RATIONALE](#)

(Operator Direction.)

CHRIS SUH: Thank you, operator.

Good morning and thank you for joining. With me today are Steve Ballmer, chief executive officer; Stephen Elop, Executive Vice President, Devices and Services of Nokia; Brad Smith, Executive Vice President and General Counsel; Terry Myerson, Executive Vice President, Operating Systems; and Amy Hood, Executive Vice President and Chief Financial Officer.

On our website, microsoft.com/investor, is a slide deck which is intended to follow today's presentation.

As a reminder, today's call is being webcast live and recorded. If you ask a question, it will be included in our live transmission, in the transcript, and any future use of the recording. You can replay the call and view the transcript at the Microsoft Investor Relations website.

During this call we will be making forward-looking statements which are any predictions, projections or other statements about future events based on current expectations and assumptions that are subject to risks and uncertainties. The potential risks and uncertainties include, among others, that the expected financial and other benefits from the Nokia transaction may not be realized, including because of factors discussed in yesterday's press release. Actual results could materially differ because of these factors, comments made during this conference call, and the risk factor section of our Form 10-K, Form 10-Q, and other reports and filings with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statement.

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

STEVE BALLMER: Thanks, Chris, and thanks to everybody for joining us on this call today. I say hello from Salo, Finland, which is one of the heart and soul development facilities for the Nokia Lumia Windows Phone. And I'm excited to have a chance to talk to you about the very bold and exciting deal or transaction



Microsoft acquires Nokia's phone business
Microsoft acquires Nokia's Qualcomm, other key IP licenses
Microsoft licenses Nokia's patents for use across all Microsoft products
Microsoft licenses ability to use Nokia HERE broadly in its products
Nokia retains NSN, HERE, its CTO Office, and its patent portfolio
Nokia and Microsoft cement original partnership with this deal before 2014 recommitment date

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that we announced today.

On slide four I just want to make sure everybody has the key elements of the deal in mind. I know it's all in the press materials but let's make sure everybody's clear.

Number one, Microsoft is acquiring Nokia's phone business, both its so-called mobile phone business as well as its smart device business.

Number two, along with the acquisition of Nokia's phone business we are also being assigned rights in Nokia's IP license with Qualcomm and other key IP licenses.

Number three, we are licensing -- not buying, we are licensing -- Nokia's patents to be able to use them not only with our Windows Phone and other phone product lines but across the Microsoft product set.

Number four, we're licensing the ability to use Nokia's HERE mapping geospatial location -- we'll use those words interchangeably today -- service to use that and modify it broadly in our products.

Nokia is a company that will continue under the Nokia name. It retains the NSN business, which is a network infrastructure business, its location and mapping business HERE, its CTO office and the patent licensing business that goes along with the advanced technology work they're doing.

With this announcement we also cement the original partnership that we put in place two and a half years ago to focus together on Nokia phones that are Windows Phones. There was a date in 2014, we call it the recommitment date in which we would each add some options on how to move forward. Quite complicated but we've been talking for a while about where we wanted to go. We think we've made excellent, excellent progress with the partnership, and yet we also know we have a long way to go, and felt in balance that together this is the best approach for both companies' shareholders.

[Note: On the left the first 3 are the [Series 40 6th Edition Lite](#) platform devices: [Nokia 109](#), [Nokia 110](#), and [Nokia 111](#). Then (with the stereo

Nokia: More Than 200M Beautiful Phones A Year



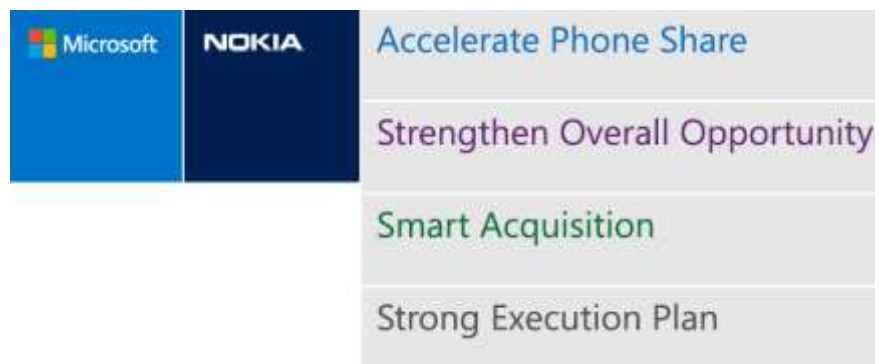
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headset) is the first [Nokia Asha software platform 1.0](#) device: [Nokia Asha 501](#). The rest are Nokia Lumia devices. What are not shown here: [Nokia 105](#) and [Nokia 106](#), the last two devices from the once quite extensive [Series 30 feature phone platform](#), like [Nokia 101/100](#) of 2011, or [Nokia 1280/1616/1800](#) of 2010. Will Microsoft kill them in the near future? Could be, but for 10 years Microsoft could use the Nokia brand for Series 30 and Series 40 based devices, while *“Nokia would be restricted from licensing the Nokia brand for use in connection with mobile device sales for 30 months and from using the Nokia brand on Nokia’s own mobile devices until December 31, 2015”*. Nokia’s [pre-Windows Phone software strategy of Dec 2009](#): *“Nokia is also continuing to use our Series 30 platform in a limited number of mobile phone devices for highly price sensitive consumer segments.” will come to an end in terms of S30 first, while the rest shown on the illustration above will evolve further on. Also [in one of the Nokia press releases](#) it is stated: “Microsoft is acquiring Nokia’s Smart Devices business unit, including the Lumia brand and products”, although [in Steve Ballmer’s e-mail to Microsoft employees](#) it is stressed that “It is very important that we pursue a unified brand and advertising strategy as soon as possible”.]*

On slide five I show you a sampling of some of the beautiful Nokia phones. **Nokia ships well over 200 million phones a year.** The vast majority of those are mobile or feature phones that get sold for prices as low as say \$25, and are often the first connection with technology that people in many places in the world have with any kind of communications or information technology device. We look at that as an excellent feeder system into the smart phone world, and a way to touch people with our services, even on much lower end devices in many parts of the world.

And so we're pleased to be acquiring the full capability of Nokia in phones, from mobile phones to smart devices, from engineering to marketing, manufacturing, supply chain management, and the like.

Nokia is a phenomenal company that we have really had a chance to work with and get to know over the last two and a half years. We knew the company earlier, but the working partnership is phenomenal.



On slide six I just want to highlight the four **key rationales** for the deal.

We're going to walk through each one of these.

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Number one and most importantly, we are trying to accelerate our phone market share. As good as the work is that we've done together, and Terry Myerson will have a chance to talk about it, we know we need to accelerate. We're not confused about that. We see opportunities to do so, and Terry will discuss that.

Number two, we want to strengthen the overall opportunity for Microsoft from a devices and services perspective, and for our partners as well. I'll speak about that later.

We're going to talk about why this is a smart acquisition from a financial and assets perspective. Amy Hood and Brad Smith will do that.

And last but not least, we'll talk about our execution plan and Stephen Elop from Nokia will have a chance to join Brad and me in that part of the discussion.

So with that, I'll turn things over to Terry Myerson. Terry has run our Windows Phone business. He now runs all of our operating systems work. He's been on the front edge of the partnership with Nokia and in championing inside this path forward, and I'm going to let Terry talk about our plans to accelerate phone share.

TERRY MYERSON: Thanks, Steve.

Hello, everyone. This is the single-most exciting deal in my 17 years at Microsoft, unlocking our potential to win in mobile devices.

This all started in fall 2010 when the Nokia and Microsoft teams began talking about partnership. We asked ourselves with two great brands, Microsoft software and Nokia hardware, what could we create? In Nokia we found great leadership, innovative concepts, and incredible engineering capabilities, not to mention a flair for original and world-inspiring hardware design.



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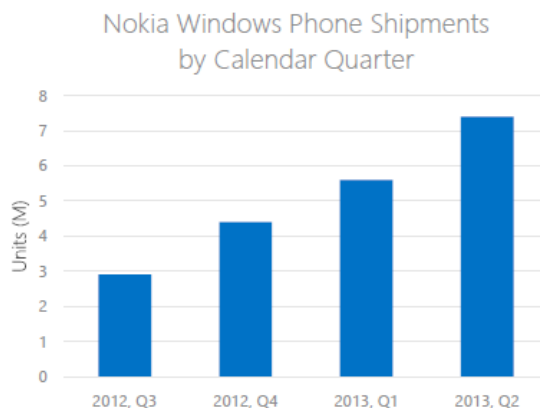
We shipped our first phone together nine months later, the Lumia 800.

Last fall, we shipped Windows Phone 8, which enabled Nokia to create a full portfolio of Windows Phones that spanned a broad array of price points in over 100 countries.

Today, we have the best-selling Lumia 520 at an entry level price point, the 620, the 720, the 820, the 920, which was voted smart phone of the year by Engadget's readers the same year the iPhone 5 and Galaxy S3 launched, and now the best camera phone in the world, the Lumia 1020.

Nokia and Windows Phone Momentum

- >10% share in 9 markets
- Outselling Blackberry in 34 markets
- 78% YOY growth



[The Nokia Windows Phone shipments for the last 4 quarters were 20.3 million units.]

In just over two years Nokia has gone from shipping no Windows Phones to shipping 7.4 million last quarter.

As a result of our Windows Phone innovations, combined with Nokia's amazing device portfolio, their capability and distribution and retail promotions, Windows Phone has reached over 10 percent share in nine markets, and in 34 markets Windows Phones are outselling Blackberry, from Australia to China to Brazil, Italy, Mexico, Russia, and the United States.

The Nokia Windows Phone momentum has made Windows Phone the fastest growing mobile platform, with 78 percent year over year growth. Every quarter for the past eight quarters more customers have activated Windows Phones than in the prior quarter.

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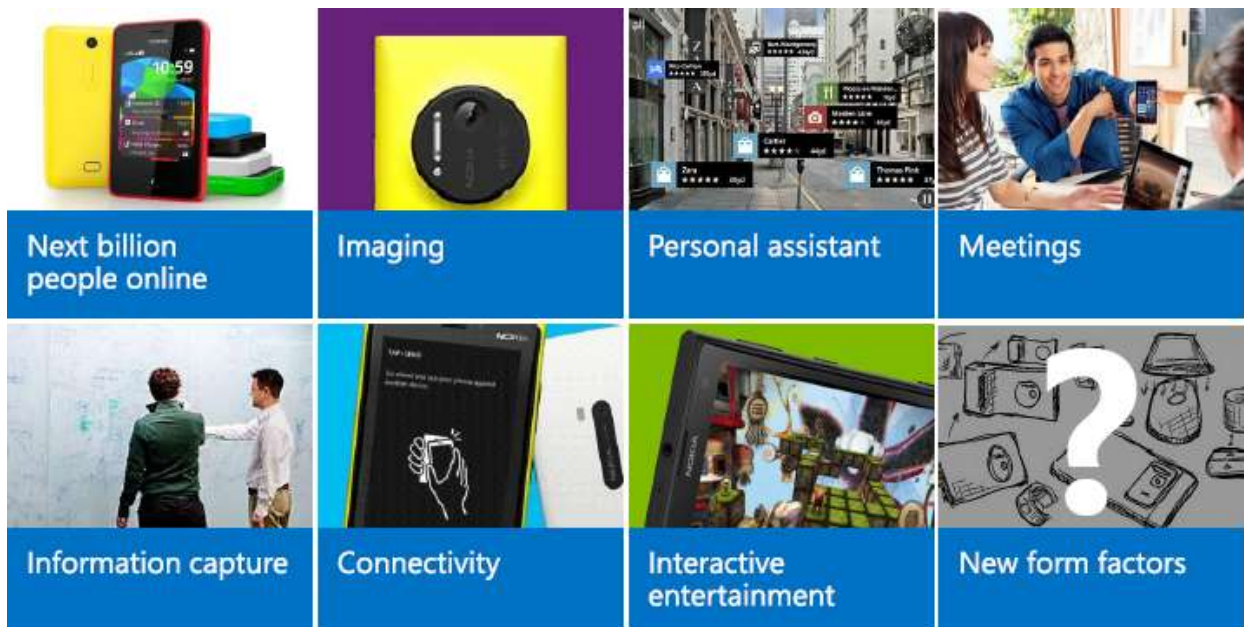
We are building momentum but we still have low share today. Last decade with Xbox and Exchange we were in the same positions, starting small. Here we aspire to the same trajectory. We need to make the market for Windows Phone. We have to go to the customer with a clear message that highlights Windows Phone's differentiation.

The marketing approaches we have used in the past are insufficient. This deal enables us to invest in a single marketing campaign, which allows us to officially



communicate the Windows Phone value proposition to consumers with **one brand** and a **united voice**, making the market for the entire Windows Phone ecosystem.

The thing I'm most excited about with this deal is how **our innovation will accelerate**. Our teams have a proven ability to work together, and this deal removes the seams in our collaboration.



Nokia's Mobile Phones Division reaches a whole new customer segment for Microsoft, shipping over 53 million phones last quarter. We are excited to partner with this team to bring the next billion people onto the Internet.

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In the area of imaging, the Lumia 1020 has no equal. We are excited to bring this technology together with our breakthrough Kinect camera technology to delight our customers.

Our phones have evolved into our personal assistants helping us navigate our days. This deal brings us a new HERE data license, which when combined with our Bing information platform will enable us to create a more immersive experience for our customers.

From the Skype and Lync experience, to next generation sensors, to how our devices connect to cloud services to the interactive entertainment to device categories not yet on the chart, the Nokia and Microsoft team share a common vision for innovation at the hardware/software boundary. Together we will now explore this boundary together ultimately creating opportunities for all Windows OEMs. Together Nokia and Microsoft have the scale to combat Galaxy, the design to combat iPhone, and the innovation capabilities to lead it all.

STEVE BALLMER: Great. Thanks, Terry.

I'd like to talk a little bit about the totality of Microsoft and how the deal strengthens us as a company in so many ways. So on Slide 13, if you will, I want to harken back to themes we've been striking over the past months, actually the past couple of years, as the **transformation of Microsoft**. The company I joined 33 years ago was a company focused on software for personal computers. And software is a great skill and will always be a core strength of Microsoft. The PC is an important device, the most productive device on the planet, and will continue to be so. And yet for us not only to grow but for us to really fulfill the vision of what we can do for our customers, we've evolved our thinking.

A family of devices with integrated services that best empowers people and businesses for the activities they value most

Greater smartphone success strengthens Microsoft and our OEMs

High value services including geospatial are key



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We need to be a company that provides a family of devices -- in some cases we'll build the devices, in many cases third parties, our OEMs, can build the devices -- but a family of devices with integrated services that best empower people and businesses for the activities that they value the most. The core deliverable for us has been software. And yet the core way in which people will consume that is through hardware experiences as well as cloud services, which is a fundamental transformation for our company, which is very, very important.

We started the cloud transformation five or six years ago. We made great progress. We certainly have been working hard on devices. The Nokia acquisition, the deal that we're talking about today, is transformational in terms of giving us the capabilities to do physical devices in addition to the work we do with our OEM partners on virtual devices for us -- that is, on Windows PCs.

I do think that we want to touch on why we believe that greater smart phone success is good for Microsoft and our shareholders, as well as our partners, and I do want to talk about geospatial services and the work we're doing with the Nokia HERE division, because when you think about the high value services of the future, these mapping and location services are essential, and we think we've made a smart win-win deal in that area.

If you go to Slide 14 15, the first thing I want to talk a little bit about is essentially “**why phones?**” There are many theories of Microsoft and where we should go that I get a chance to read here from investors, from journalists. And in a simple way, I would say much as apps help operating systems and operating systems help apps, devices help services and services help devices. Being successful with end users -- I'd use the word consumer, but it implies that people don't have a work life and a personal life, a professional or productive life, and a fun life. But, being successful with users is absolutely vital to succeed, both at work and at home.

When people talk about the consumerization of IT, that's a phenomenon that we grew up with. The PC represented the first consumerization of IT. If you want to, as we do, then to capture a large user base, real people who use our products in many aspects of their lives, you must focus either on consumer services,

Devices and Services: Why Phones?

- Devices help services and services help devices
- With the consumerization of IT, users matter at both home and work
 - Devices and high volume/value services are ways to build a large user base
- Microsoft and phones
 - High value experiences light up on great devices
 - Device innovation gives Microsoft economic opportunity
 - We will continue to support iPhone and Android/Galaxy phones with our services
 - But we cannot risk having Google or Apple foreclose app innovation, integration, distribution, or economics
 - We need a first-rate Microsoft phone experience for users
- Windows: 300M+ devices a year
 - Success in phones is important to success in tablets
 - Success in tablets will help PCs
 - We will take additional steps to promote the app ecosystem for Windows

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devices, or some combination.

And I would say that in many ways we're coming at both of these, but devices are particularly important as a place to capture and really involve the end user. And frankly, while we continue to pursue service opportunities, and we see great opportunities particularly for revenue upside in our Bing service, the device opportunity is perhaps the best opportunity for pursuing users in very, very large numbers.

The phone as a device is, of course, obvious. It is the most popular intelligent device now on the planet. And it's important for us to really make sure we have an innovative, high quality experience that lights up on great devices. We do think that there will be innovation in hardware and in software and that will give opportunities for us to build market share in the phone as a device, and that brings with it profit opportunities. I continue to believe that there's enough innovation in devices, unlike some of our investors, that it will be a growth opportunity in terms of the financial rewards to the bold, to the innovative who pursue it.

We will, as we do today, support both iPhone and Android Galaxy phones with our services. We're not holding back services from other phone vendors or platforms in any way. On the other hand, we cannot do a full and first-class experience on those platforms, the level of integration, the level of device support, the level of economic tax taken by the platform vendor, all of those things we run the risk that Google or Apple will foreclose our ability to innovate, to integrate our applications the way we have in Office, to do distribution, or to impose economic terms. And for all of those reasons, not only in an offensive aspect, but in a defensive aspect, we think it's very important to have an absolutely first-rate Microsoft Phone experience with integrated software and services.

We're not new to devices. There will be over 300 million Windows devices sold this year. Certainly as I talked to our hardware partners in PCs and tablets, they agree with me passionately that success in phone is important to success in tablets. And I've already had a chance to talk to a number of our big OEMs who are excited about the transaction that we're announcing today with Nokia. We also know that there's a relationship between tablets and PCs. So in some senses, a successful investment in Windows Phone, and the Windows ecosystem should help raise the tide of everything that we do, and we know that that rising tide attracts application developers, and we recognize the gaps we have in application ecosystems today, particularly on Windows Phone.

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On Slide ~~15~~ 16 I want to talk a little bit **about why** we think we need to do our own **phone hardware**, and what the ongoing opportunity is for our OEM partners. As we discussed, Windows Phone has achieved the number three

position in smart phones globally. Some of you say three is not two, and not one. I will tell you, you cannot get to be two until you are three, and we will work very hard on the opportunities that are in front of us. But, what it means is we have the smallest share of the real contenders, and today a very high concentration, over 80 percent of the Windows Phone business is already with Nokia.

And so in terms of evaluating the paths that would ensure that we continue to see great Windows Phone devices from the Nokia team, and in an attempt to really ask what's the most sensible economic model, it made sense for us to go first-party, have our own phone, to ensure a Windows Phone presence. We looked at various OEM alternatives continuing an OEM only model, those actually look prohibitively expensive from a marketing standpoint, and this actually looks to us to be the best risk-return and upside opportunity for our shareholders.

Terry talked about why an acquisition is better than continuing from an innovation and marketing standpoint in an arms' length relationship with Nokia, and so we think the combination gives us the maximum opportunities and Amy will talk some about that from a financial perspective.

We absolutely believe this acquisition grows our OEM opportunities. More success with phones helps our OEMs in tablets and PCs. I've talked to a number of OEMs who are more enthusiastic today than they were yesterday about pursuing Windows Phones, because they know we have a flagship product with which to blaze trails in this market. And there is plenty of opportunity for OEMs to address the diversity of markets that are out there, and I'm pretty excited. It's a different model than the PC model, but I'm pretty excited about the way in which we can balance our own first party hardware and get support and help that's important from our OEMs.

Devices and Services: Why Phone Hardware? Driving Ongoing OEM Opportunity

- Windows Phone has achieved #3 position in smartphones globally
- Acquisition protects Windows Phone future
 - High concentration with Nokia
 - First party hardware ensures Windows Phone presence
 - OEM model alone expensive in this market position
- Acquisition reduces friction moving forward
 - Pace of innovation
 - Marketing efficiency
- Acquisition grows OEM opportunity
 - Address diversity of markets
 - Continue existing partnerships
 - Microsoft success creates expanded OEM opportunity

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On Slide 16 17, in some senses the question is why **Nokia**?

We're going to do phone hardware. There's absolutely no question in my mind that Nokia is a first rate company when it comes to device design and engineering. We know that from working with their teams and seeing their products, device distribution

and sales, supply chain, operational processes, hardware distribution, and they can do all that today with Windows Phone. I think there's no question that if we're going to need to be and want to be a scale player at hardware, then having a culture, a set of processes, a set of talents and people who really know how to run a first rate hardware business is essential. We certainly think we have many talented hardware engineers, but Nokia has a very, very capable team. A team that ships as many electronic devices as almost any company on the planet now becomes part of Microsoft. And I'm very excited to welcome the Nokia team. I'm traveling in Finland for the next few days meeting people beyond the leadership team, and I think it's really exciting to see the team that's here.

Finally, I want to talk a little bit about **high value services**

[slide #14]. Nobody buys hardware for hardware, and it's sometimes hard to get real end users to buy services without buying hardware. So we think about, as I said, devices with services. And with Office, with Skype, with

Xbox Entertainment Services, SkyDrive, Bing, we have a powerful lineup of first rate services to deliver on high value experiences. But in the mobile world mapping is essential, and we need a very effective alternative to Google for mapping. It is important to many players, including Microsoft, that there be more than one digital map of the world.



High Value Services Including Geospatial

- Office, Skype, Xbox Live, SkyDrive, Bing at Microsoft
- Geospatial and mapping essential to integrate for mobile
- Need an effective alternative to Google; more than one "digital map of the world"
- Nokia can maximize HERE use by others
- Microsoft gets flexibility to integrate HERE with other experiences
- A new, simpler, and more effective partnership for the future
 - Microsoft acquires rights equivalent to ownership for the HERE mapping apps
 - Nokia will continue to improve these apps for other platforms
 - For mapping data and services, under a new four-year agreement:
 - Nokia will provide Microsoft with mapping data services in exchange for annual payments
 - Microsoft can combine Nokia mapping data with data from other sources
 - Microsoft can syndicate Nokia's data to customers using Windows Azure for additional fees

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What we're doing in the partnership today, what we'll do with this transaction, Microsoft will get flexibility to integrate Nokia's HERE geospatial assets into all of our experiences. We'll have great freedom to innovate around the HERE location platform, and yet Nokia can maximize the use of the HERE asset by other industry players. Like every other aspect of the deal being announced today, we examined many possibilities and collectively decided that the new partnership is simpler, more effective, and more likely to lead to economic success for both entities, and a real second digital map of the world.

We will become, with the conclusion of this transaction, we will become a top three customer for Nokia. Those economics are outside of the acquisition economics that we summarized in the sheet. But they're in the analysis that Amy Hood will now share with you.

Amy, do you want to talk some about the smartness, so to speak, of this acquisition?

AMY HOOD: Absolutely. And hello everyone.

As Steve and Terry have both mentioned, today is a very exciting day for Microsoft, and we feel great about the opportunities this deal represents to drive long term shareholder value and both top and bottom line growth.

As we turn to Slide 19, let me get into a few specifics of the deal. There are really two primary components. First, we are paying 3.79 billion euros for Nokia's Devices & Services business, which includes thousands of design patents, key brands, and the benefit we receive from Nokia

assigning its patent licenses with third parties to Microsoft. Additionally, 1.65 billion euros is being paid to license Nokia's broad intellectual property portfolio for 10 years, with an option to convert to a perpetual license. We consider this portfolio to be among the best in the mobile industry. And we will be able to leverage it across Microsoft's entire portfolio of products. Brad will cover the details on these key assets in a few minutes.

Smart Acquisition

Deal Overview

- €3.79 billion for Nokia's Devices and Services business including key patents
 - €1.65 billion for a broad intellectual property license
 - Uses offshore cash; no impact on ability to return capital to shareholders
- IP and patent agreements have material value

Mobile phone business provides entry into key growth markets

Improved unit economics

Long term value creation

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The combined purchase price will be paid using offshore cash. We do not believe that this transaction will impact our ability to continue to return cash to shareholders. In addition to the Lumia brand of products, an important component of Nokia's devices and services business is the scale and breadth of their Asha branded phones and other phones developed by the mobile phone business unit. Nokia sold over 53 million mobile phone units in their second quarter. And their strength in growth markets creates a unique opportunity for Microsoft to reach these users as they transition to smart phones. And many of Nokia's strongest smart phone markets are places where the mobile phone business was a key part of that foundation.

Now to Slide 20, earlier Terry walked through some of the benefits that we'll gain from the deal, particularly from an engineering and go to market perspective. Additionally, this deal affords us **greater economic opportunity**. Under the commercial deal that was in place, we were capturing less than \$10 per device in

software royalty gross profit, then making platform payments to Nokia, and investing in sales and marketing support to grow the business. By owning the Devices & Services business, Microsoft will now be able to capture and utilize the entire growth process of the device, which for Lumia was about \$40 per unit in Nokia's most recent quarter.

Using assumptions that are in line with industry forecasts and current performance and trajectory, after it is integrated into Microsoft we estimate that we will achieve operating income break-even for this business when we sell approximately 50 million smart devices a year. For reference, Nokia sold over 7 million Lumia units last quarter, up 32 percent sequentially. As we continue to drive further scale, the per-unit profitability is significantly better for us with this acquisition.

Now to Slide 21, we expect this deal to have a negative 8 cent impact on an adjusted basis, and a 12 cent impact on GAAP earnings per share in Fiscal 2014, based on a close date in early calendar 2014. Adjusting for acquisition-related amortization and integration expenses, we expect the deal will be **accretive in a non-GAAP basis in Fiscal Year 2015**, driven by both increased smart device unit volumes, and cost synergies.



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Cost synergies are expected to occur across both companies over a wide variety of functions. We are committed to operating this business efficiently. As Steve mentioned, Nokia brings significant expertise in areas such as supply chain and demand planning, and has mature operational systems in place that will be a key asset for the combined entity.

[15% of the 1.7B units in 2018 is 255M units. The ~\$45 billion estimated revenue at that time means ~\$176 ASP. Considering the latest Q2'13 EUR 157 [\$207] ASP of Lumia it seems feasible, but in 5 years timeframe it needs a **strong premium strategy** to achieve that. ... NPV – [Net Present Value](#).]

On Slide 22 with this deal we have a real opportunity to materially drive long-term shareholder value. The smart phone market is expected to reach over 1.7 billion units a year. And as Steve and Terry discussed, this acquisition better positions our company to compete in that market. The directional values presented here are those directly related to the acquired devices and services business. In addition, we believe there are opportunities to create additional value with a positive impact on our family of devices, particularly tablets, but also PCs, along with our portfolio of business and consumer services. Those impacts are not included in these numbers.

Before I hand it off to Brad, let me leave you with this: with this acquisition we have an opportunity to fundamentally change the economic structure of our mobile business. It is a change that as the business grows presents an opportunity to deliver enhanced economics with significant additional benefits to other businesses across the company. With the commercial deal showing positive early momentum, and both companies assessing their strategic positions,

Accretive to Adjusted EPS by FY15

Expected EPS Impact



- The transaction is expected to be accretive to FY15 Non-GAAP EPS*
- Expected to be accretive to both GAAP and Non-GAAP EPS in FY16
- Annual cost synergies of \$600M within 18 months after close

Long Term Value Creation

Outsized financial opportunity fueled by growth in smartphone business

Smartphone Revenue Opportunity	
2018E Worldwide Smartphone Shipments	1.7 billion
Assumed Market Share	15%
Annual Revenue	~\$45 billion
NPV	
Assumed Operating Margin	5% 10%
Annual Operating Income	\$2.3 billion \$4.5 billion
NPV	\$15 billion \$30 billion

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this was the right time to make this deal. And with strong execution it is an acquisition that delivers a significant economic return.

Now, let me hand it over to Brad. He's going to talk through some of the details regarding the patents and the intellectual property.

BRAD SMITH: Thanks, Amy. And hello, everyone. Let me turn to slide 23 and talk a little bit about the **IP aspects** of this.

If you step back and think about it, it's pretty self-evident that an important part of managing a smart devices business well, is the management of intellectual property rights. Anybody who reads the news will see that if you don't do a good job, you

run that risk that you infringe other people's patents, your shipments can be enjoined. Even if you are able to secure licenses, if you're not creative in the way you put all of this together, you can drive up your costs. And, indeed, for some companies, the patent costs amount to 10 percent or more of their bill of materials. For other companies, it's substantially lower.

We put a lot of thought as we've structured this transaction and considered the company's strategic opportunities at addressing the patent issues.

If you look at what we're getting in this agreement, it really breaks down into a few pieces. Number one, there are some IP assets that are being transferred from Nokia to Microsoft. This includes about 8500 design patents. These are the patents that distinguish the physical features of a product from another product.

It includes the transfer of two important brands, the Asha brand and the Lumia brand. And we secured a ten-year license to use the Nokia brand on feature phones. So that's what is being moved over in terms of ownership.

Second, there's a patent license for which Microsoft is paying 1.65 billion Euros. This involves the right to, in effect, make use of Nokia's inventions, it doesn't involve the transfer or ownership of the patents itself. But what it does give, it gives Microsoft a license for all Nokia's patents, except for the NSN patents. It gives us the option, which we'll exercise, to convert this

IP Acquisition and License Agreements with Nokia

- Intellectual property is an important element of the smart devices business
 - Unless managed proactively, patent issues can create uncertainty for smartphone shipments
 - Unless managed creatively, patent royalties can add over 10 percent to the costs of a smartphone Bill of Materials
- Microsoft is acquiring over 8,500 design patents, ownership of the Lumia & Asha brands, and a ten-year license to use the Nokia brand on feature phones
- Microsoft is paying €1.65 billion for a fully paid-up license to Nokia's utility patents
 - Covers all of Nokia's patents and applications as of the closing date (except NSN)
 - The total license price includes an option to convert coverage from a ten-year to a perpetual license
 - The agreement provides for a broad, five-year, two-way standstill, including NSN
- Nokia's patent portfolio is one of the most valuable in the tech sector
 - Nokia's portfolio has approximately 30,000 utility patents and patent applications; we consider it to be one of the two most valuable portfolios relevant to wireless connectivity
 - The license also provides significant value for Microsoft's existing businesses, replacing after 2014 Microsoft's existing annual license payment to Nokia

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license from a ten-year license to a perpetual license, meaning we'll have patent coverage for the life of all those patents. And it also has a broad, five-year, two-way standstill between both companies, including the NSN patents.

One of the reasons we focused so much on securing this license, one of the reasons it has a high price tag, is because of the very substantial value of Nokia's patent portfolio. When we look at the industry, and in particular, when we look at patents that are relevant to wireless connectivity using the CDMA standard or the GSM standard or 3G or 4G technologies, we really believe that Nokia has one of the two most valuable portfolios in the industry. The other is Qualcomm's.

So we secured the right to use those patents as we produce and innovate in this device space going forward.

There's also some significant value for our existing business. We've been making annual patent royalty payments already to Nokia for our existing businesses, and we assign roughly a quarter of the value of the 1.65 billion-Euro patent license to these existing businesses.

If you go to slide 24, you see the other part of what is a very significant aspect of this transaction. In our view, Nokia's been one of the smartest -- I'd go as far as to say the most sophisticated and smartest device company in securing the patent rights it has needed to produce smart devices, smart phones.

Microsoft Also Secures Other Valuable Patent Benefits

- Nokia is assigning to Microsoft benefits under more than 60 patent licenses with third parties
 - Nokia is assigning its existing license with Qualcomm, which is the other company that ranks with Nokia at the top in having a valuable wireless patent portfolio
 - Nokia is also conveying rights under its agreements with IBM, Motorola Mobility, and Motorola Solutions
 - These give Microsoft the benefit of attractive royalty arrangements Nokia negotiated
- Microsoft will combine the new Nokia license and these assignments with its existing patent agreements
 - Microsoft's agreement with Samsung will provide coverage for these additional devices without added payments
 - Microsoft will also benefit from its prior or continuing agreements with Apple, LG, Nortel, Kodak, and others at no additional cost
- Put all together, Microsoft will have the most cost-effective patent arrangements for smart devices

And under this agreement, the benefits of over 60 patent licenses that Nokia has negotiated with third parties are assigned to Microsoft. The most important of these is with Qualcomm. Nokia reported publicly that it negotiated a 15-year license that went into effect in 2008 with Qualcomm. It paid Qualcomm 1.7 billion Euros, it also transferred to Qualcomm a number of Nokia patents. And as a result, Nokia has what we regard as an important and attractive patent arrangement in place with Qualcomm. We now benefit from that arrangement.

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But it's not Qualcomm alone. There are a number of other important third parties as well from which we'll now get the benefit of the existing licenses.

We get to combine that with the license agreements we've been putting in place over the last few years. And typically over the last few years, as we've negotiated patent agreements with other companies, we've bargained for the right to produce devices if we wanted to go that route.

So our existing agreement with Samsung gives us coverage under Samsung's patents without paying additional money. The same is true for a number of other patent agreements that we have in place.

When you put all of this together, the IP assets that are transferred, the Nokia patent license, the patent licenses that are transferred from Nokia to Microsoft, we believe it puts us in the position to have the most cost-effective patent arrangements for any company in the smart devices space.

STEVE BALLMER: Great. Thanks very much, Brad. I'm going to turn to slide 26 and talk some about the **execution plan**.

One of the things which I think we're most acutely focused in on is how do companies really make big acquisitions work? In this case, we have two and a half years now of experience in making many aspects of this acquisition work. Our

Nokia executives on board assuming key roles
Device/supply chain consolidation
Phone device R&D centered in Finland
Marketing/services consolidation
Nokia sales team intact
Integration executives mobilized
Working rhythms intact



partnership provides us with great confidence. We know the people. We can produce products together. We know how to go to market together. We can do it all more efficiently, we understand that. More effectively, we understand that.

I have to say, I don't know whether we would be here if we hadn't already operated under our current collaborative agreement to do so much great work.

So building on the existing partnership and the structure of the deal, I spent time with Nokia's senior team on the Devices & Services side, as did Terry Myerson and others as part of the transaction and associated with the transaction. Stephen Elop and, frankly, most of the leadership team from Nokia on the Devices & Services side has signed up, excited, moving over to Microsoft so that we have the opportunity to execute on this without missing a beat. The

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leader of the smart devices side, the mobile phone side, the talent and expertise Juha brings in operations. Chris Weber, who runs the field all intact. Stefan Pannenbecker has done some of the most important design on Lumia joins as part of this deal. We'll hear from Stephen Elop in just a moment.

We have a structure for the integration that makes sense to us. Stephen will run our integrated devices organization and his team on the engineering and supply chain side will come with him and will be kind of the center under which we integrate devices and supply chain will be with Stephen.

Our phone/device R&D will be centered here in Finland. We will consolidate marketing as well as the development of software services.

The Nokia sales team, importantly, will stay intact. We need that team out there every day not only just to close, but post-close really generating the sales through the relationships with the operators and we think we've got a good plan there.

We have integration executives mobilized on both sides. Tom Gibbons, who's been with Microsoft over 20 years in a variety of hardware and software aspects of our business will lead, as will Juha Putkiranta on the Nokia side. As I said, we have working rhythms between the two companies that are intact.

I'd like to turn things over to Stephen Elop who will lead the Microsoft devices effort post closing and is currently -- well, as of yesterday, was CEO of Nokia, and now is EVP of the Devices & Services division of Nokia. Stephen?

STEPHEN ELOP: Thank you, Steve, and I'm glad to be able to join you on the call today.

At Nokia, we've been building momentum around our Lumia products steadily over the last four quarters. We've continued to connect the next billion people with new advances in our mobile phones business. We've been going faster than Nokia has ever gone before and as other manufacturers have fallen by the wayside or gone sideways, we're achieving our goal of becoming the third ecosystem is becoming very real.

And that is one of the reasons Nokia and Microsoft have entered into this transaction. We believe this transaction will accelerate the momentum of the devices and services business. By bringing our teams together, we can increase our share in smart devices through faster innovation, through better products, and through unified branding and marketing.

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In short, we can reduce the natural frictions in the system between our two companies. We can invest more resources into the effort, and we can build on the momentum that has already been established.

As well, the potential for what we can do with mobile phones goes up, as we are presented with the opportunity to bring a rich array of Microsoft services to first-time smart phone users, and as we create an onramp to Windows Phone for people that are having their first smart experiences. Our likelihood of success with devices and services goes up as a result of this transaction.

When Steve and I first discussed the original partnership between Nokia and Microsoft in early 2011, we spent a lot of time focused on designing how our companies would actually work together. We put in place the organizational structures and management rhythm necessary for our teams to jointly design and engineer the award-winning products that we have since delivered.

Our collective teams have now had two and a half years of experience with working together side by side every single day. This represents a huge advantage as we enter this transaction because we already know each other. We have learned how to solve problems together, and we continue to share the same broader goals.

That experience with Microsoft, combined with our passion to win with our strategy, has allowed us to confirm that we will be bringing a very talented and motivated team across to Microsoft.

For example, Jo Harlow will join Microsoft and will continue to lead smart devices. Timo Toikkanen will join Microsoft and will continue to lead mobile devices. Juha Putkiranta will join Microsoft and will lead the integration effort between our companies on behalf of Nokia, while continuing to lead operations for us.

Stefan Pannenbecker will join Microsoft and will lead design. Chris Weber will join Microsoft and will lead the devices sales team with **the Nokia sales team being the nexus for Microsoft's devices sales team going forward.**

And as we speak, dozens of other leaders at Nokia have already confirmed their commitment to the success of this next chapter, and are as we speak helping everyone else at Nokia through what is an emotional period of time.

I'll be focused on leading the talented and passionate teams of Nokia through this transition. I'll concentrate my efforts in the months immediately ahead on the Devices & Services business

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within Nokia. And when the transaction with Microsoft closes, I too will transfer to Microsoft and become the EVP of devices.

We have exciting innovation across Nokia's smart devices and mobile phones. And with a strong plan for execution, we can accelerate the current momentum to be a more successful leader in the mobile market. Thank you, Steve.

STEVE BALLMER: Thanks, Stephen. I just want to underscore one point before I pass things to Brad to talk about regulatory, which is kind of the next step.

I am incredibly proud of the products that we have produced with Nokia. The Lumia Windows Phones in market are some of the best products Microsoft has ever built in terms of capability, design, and quality. We're very, very firm in our commitment and belief. We have work to do to establish even greater differentiation. We have work to do on the so-called application gap. We have work to do for market success. But we have created absolutely first-rate products of which we are all, at Nokia and Microsoft, incredibly proud, and we will continue that as we move into this new space.

Brad, why don't you talk a little bit about **regulatory approval**?

BRAD SMITH: Sure, thanks, Steve. An acquisition involving two global companies, not surprisingly, this involves merger review by a number of governments and regulatory authorities around the world. So we'll be moving quickly to submit this for the requisite approval in the European Union, the United States, China, in countries such as India, Brazil, Russia, Canada, maybe others.

Confident About Regulatory Approval

- We will submit the acquisition for approval in the EU, U.S., China, India, Brazil, Russia, Canada, and other countries
- We are confident about our prospects for approval by early 2014
 - The acquired assets are complementary
 - The acquisition will promote competition
 - Integration of hardware and software will help Microsoft offer competitive alternatives to Google and Apple
 - Microsoft will gain proven capability and talent critical to success in devices and services
 - Microsoft remains committed to working with partners in the Windows & Windows Phone ecosystems
 - The acquisition will benefit consumers
 - Will drive down Microsoft's devices and services costs from development through go-to-market and by obtaining cost savings from Nokia's existing IP licenses
 - Provides consumers with more choice and innovation

We're confident that we'll secure regulatory approval in the first calendar quarter of 2014. And I think the basis for our confidence is pretty clear. Number one, this is an instance where you really see complementary assets coming together. Microsoft and Nokia are not competing in this space today, in fact, we're already partners that are collaborating.

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And the essence of the rationale for regulators is clear as well. We will be more effective as a competitor in the market by bringing all of these strengths together than by operating separately or through this partnership in two different companies.

We get to bring together the new capabilities to Microsoft that Nokia has really excelled at over the years, that includes everything from design and manufacturing and inventory and supply chain management to the other aspects that are critical to being in the devices business. That will make us more effective.

As Amy pointed out, the economics will enable us to be more effective. In short, we will be a stronger number three, and regulators like it when the number-three competitor in a market has a better opportunity to challenge the two market leaders.

And at the same time, as Steve has highlighted, we're committed to continuing to work with our partners in the Windows and Windows Phone ecosystems. Indeed, we believe our success in phones will help our partners when it comes to other areas, especially tablets and PCs.

Ultimately, as we all know, regulators, quite rightly, look first and foremost at what a deal will mean for consumers. In this instance, we believe emphatically that this is good news for consumers. By bringing together hardware, software, and IP licenses, we're in a position to drive down our costs. We're in a position to accelerate innovation. We're in a position to offer consumers more choice, better innovation, and stronger products. That, in short, is what regulators look to approve. That's why we're confident we'll secure approval for this.

STEVE BALLMER: Fantastic. Chris, I think that pretty much wraps up and we would love a chance to take some questions.

OPERATOR: Walter Pritchard, Citigroup, your line is open.

WALTER PRITCHARD: *Great. Thanks for taking the question. Steve Ballmer, on the tablet side, obviously, we could say many of the same things as you've put into this slide deck as rationale for doing an acquisition on the phone side as we could say about the tablet side including picking up more gross margin.*

I'm wondering how this transaction impacts the strategy going forward in tablets and whether or not you need to, in a sense, double down further on first-party hardware in the tablet market. And then just have one follow up.

STEVE BALLMER: Okay. Terry, do you want to talk a little bit about that? That would be great.

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TERRY MYERSON: Well, phones and tablets are definitely a continuum. You know, we see the phone products growing up, the screen sizes and the user experience we have on the phones. We've now made that available in our Windows tablets, our application platform spans from phone to tablet. And I think it's fair to say that our customers are expecting us to offer great tablets that look and feel and act in every way like our phones. We'll be pursuing a strategy along those lines.

STEVE BALLMER: Tablets is an area where we absolutely have our own first-party hardware, as you know, and see opportunities to continue to build and strengthen. And it's an area where we have very strong programs in place with our OEMs, particularly on the Intel Atom-processor-based product lines that people will really get a lot of value on, and you'll see a range of new products coming for the holiday season.

WALTER PRITCHARD: *And then, Terry, can you talk about just the ability to scale Windows down? Obviously, Nokia has a large base of very low-price feature phones. That base may be sort of dwindling over time, but you've been cost-reducing Windows, the specs and so forth, to be able to get Windows down to low-price devices. Can you talk about any efforts to accelerate that process given potentially access to a much bigger pool of low-cost phones that are out there already?*

TERRY MYERSON: It's definitely a priority for us to bring Windows to as many customers as we can around the world. Lower-price phones is a strategic initiative for the next Windows Phone release, but we have nothing more really to say now.

STEVE BALLMER: Operator, we'll move to the next question please, thanks, Walter.

(Break for direction.)

OPERATOR: Our next question is from Mark Moerdler from Sanford Bernstein, your line is open.

MARK MOERDLER: *Thank you. Steve Ballmer, two questions: The first one is how does this affect the reorg? Given hardware was in one group and operating systems in another, software in another, does the Nokia device -- does the merger affect that? Does it merge into the hardware business, and hardware/content device group? Or does this now change that? And then I have a follow up.*

STEVE BALLMER: No, the reorg is absolutely intact. Obviously, the devices business has a broader scale and new capability. Julie Larson-Green, who is running devices and studios is flat out. We've got a lot of work we're doing here over the next several months. And Julie and her

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team will work on a planning and integration phase. Julie will continue. She's excited about working on devices, but absolutely, the critical mass of the group with that acquisition is in the phone space, and Stephen Elop will run the group and will take the appropriate steps with Julie working with Stephen to figure out appropriate integrations.

MARK MOERDLER: *Excellent. And then as follow up on it, what's your expectation going forward in terms of -- I just want to clarify this -- the percentage of Windows Phones that will be from OEMs?*

STEVE BALLMER: Today, Nokia, as I said, is well over 80 percent of all of our phones, and I don't foresee that changing dramatically in the short run, but as the market grows, I expect to see additional percentages, if you will, go to our OEMs, but it's premature to predict today. We definitely have interest from OEMs in the Windows Phone opportunity given that people understand we're going to blaze the trails here with our own first-party hardware.

MARK MOERDLER: *Thank you very much, appreciate it.*

CHRIS SUH: Thanks, Mark. I just want to remind you, we do want to get to as many questions from as many of you as we can. So I do ask that you please just stick to one question and avoid long, or multi-part questions, please. Operator, next question, please.

OPERATOR: Brent Thill, UBS, your line is open.

BRENT THILL: *Thanks. Just on the cost rationalization. Nokia has 32,000 employees versus Microsoft at 99,000. A considerable bulk of employees. Can you just talk about the rationalization over time and your view how that plays out?*

STEVE BALLMER: Amy will take it. I do want to highlight that in many hardware companies, manufacturing labor is primarily outsourced. And Amy can remind us the numbers, but in Nokia, there is more in-sourced manufacturing. Nokia has had a strategy about that that, obviously, they've executed very well. But you kind of have apples and oranges a little bit between the 32,000 and our almost 100,000. But Amy, why don't you provide some context and detail?

AMY HOOD: Sure. Thanks, Brent. About 18,000 of those 32,000 employees are really directly a part of the manufacturing business. And so I think a better way as you think about the scale and opportunity is to really focus on the percentage of Nokia outside of that.

I think both Steve and Stephen did a thoughtful job in the execution slide about talking about the philosophy we're using as we go through the integration process around the benefits of the incremental sales force that we're getting with Chris and his team, as well as really going

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through and being thoughtful about the rationalization so that we get to one voice, one brand, one team that can best execute and be efficient.

CHRIS SUH: Thanks, Amy. Next question, please, operator.

OPERATOR: Keith Weiss, Morgan Stanley, your line is open.

KEITH WEISS: *Thank you guys for taking the question. You guys have talked about the success and the partnership to date in putting out some really good products. I was wondering, Steve, perhaps you could give us some concrete example of what does the acquisition enable you to do that you guys couldn't do through the partnership? And maybe give us some more concrete examples there. Or is that maybe not the point? Maybe the point is more so that this really solidifies Microsoft's presence in the smart phone market, and this is more about ensuring that you guys are going to be a presence here for a long-term basis.*

STEVE BALLMER: Well, the latter is certainly true. We see at least three distinct opportunities to do better as one company than as two.

Number one, we talk about one brand and the unified voice to the market. I will say that I think we can probably do better for consumer name than the Nokia Lumia Windows Phone 1020. And yet, because of where both companies are and the independent nature of the businesses, we haven't been able to shorten that. Just take that as a proxy for a range of improvements that we feel we can make, we can simplify, the way in which we work with operators and the overall consumer branding and messaging gets much simpler. That is an efficiency of being one company.

On the innovation front, we've done a lot of great work together, and yet as two companies, there's always some lines along which it's hard to innovate. The Lumia 1020 is awesome in terms of what it has for camera and imaging, and yet I think as one company we would have doubled down on that bet and made an even greater range of software and services investments around the core hardware platform.

Third, I think we get business agility. As two companies, we're making two independent sets of decisions about where and when and how to invest by country, by operator, by price point, and there is, let me say, an inefficiency financially as well as a lack of agility that comes with that.

So in all three of those areas, despite the fact that I think we've done a really good job, we can improve and accelerate quite noticeably.

KEITH WEISS: Excellent, thank you.

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CHRIS SUH: Thanks, Keith. Operator, I think we have time for two more questions, next question, please.

OPERATOR: Rolfe Winkler, Wall Street Journal, your line is open.

ROLFE WINKLER: *Hi, you guys have 15 percent, a fairly aggressive market share assumption for where you guys are going to go in a few years. I guess I'm wondering, to get there, one thing you're going to need is a lot of developer support. Developers already have IOS, Android -- you can make an argument that HTML5 over the next few years will grow, that will give them a third development platform. How will you guys convince them to develop for Windows Phone?*

STEVE BALLMER: Terry, why don't you talk a little bit about developers, if you don't mind?

TERRY MYERSON: Well, for developers today, Windows offers an incredible opportunity with the installed base of PCs, phones, and tablets, and soon the new Xbox One. We want to offer them this opportunity to build either HTML5 applications or native applications that span all of those devices, enabling them to reach segments of users on those devices, users in an enterprise, users on a gaming console, and just provide them **very unique** opportunities to monetize their application investments.

So we're pretty excited about the platforms we're bringing to market. Developer reception in some areas is certainly better than others, but overall we're making progress, and we know we've got a lot more work to do.

STEVE BALLMER: One of the keys, of course, is driving volume. We think we have differentiated products. We can tell the story a little bit better. We can get the volume up, and we have over 160,000 applications in the store. We know we have a long way to go, and the key is really offering with our own first-party applications and first-party hardware, enough reasons to buy to drive volumes and then attract the broader developer ecosystem.

Obviously, HTML5 would be kind of a neutral thing. I would expect all the major platforms to embrace it to some extent. And in some senses, it takes away a little bit of the apps barrier to entry, which we know we need to work hard on right now.

CHRIS SUH: Thanks. Operator, let's move to the last question, please.

OPERATOR: Our last question comes from Rick Sherlund.

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RICK SHERLUND: *Thanks. I wonder if you could just share with us whether ValueAct was made aware of this before they entered their cooperation and standstill agreement.*

STEVE BALLMER: Brad, do you want to take that?

BRAD SMITH: The answer is no. You would not expect the company to disclose material, non-public information to an entity that doesn't have an appropriate non-disclosure agreement. So the answer is no.

RICK SHERLUND: *Okay, thank you.*

CHRIS SUH: Okay, so that will wrap up our call today. Thank you, again, for joining us. We look forward to seeing many of you at our financial analyst meeting, which will be held on September 19th. Thanks again.

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