Qualcomm reported dismal financial results for the fourth quarter of fiscal 2014. Both the top and the bottom came in below the respective Zacks Consensus Estimate. Qualcomm is facing challenges related to its licensing business in China. Management stated that the company is currently in royalty dispute with a major customer in that country. Moreover, some small companies are yet to agree on royalty payment. Some companies are also under-reporting the amount of phones sold, for which they should have paid license fees. Meanwhile, Qualcomm's latest chipsets for WiFi, RF360, multimode 3G and 4G LTE from its flagship Snapdragon platform have been doing extremely well. The company leads the global mobile baseband chipset market. We believe the stock is currently fairly valued and therefore, reaffirm our Neutral recommendation.

SUMMARY DATA

<table>
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<th>Risk Level</th>
<th>Average,</th>
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<tbody>
<tr>
<td>Type of Stock</td>
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</tr>
<tr>
<td>Industry</td>
<td>Wireless Equipm</td>
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<tr>
<td>Zacks Industry Rank *</td>
<td>57 out of 267</td>
</tr>
</tbody>
</table>

52-Week High $81.97
52-Week Low $67.67
One-Year Return (%) -1.19
Beta 1.16
Average Daily Volume (sh) 9,651,143
Shares Outstanding (mil) 1,663
Market Capitalization ($mil) $116,926
Short Interest Ratio (days) 1.07
Institutional Ownership (%) 77
Insider Ownership (%) 1

Annual Cash Dividend $1.68
Dividend Yield (%) 2.39

5-Yr. Historical Growth Rates
Sales (%) 25.5
Earnings Per Share (%) 22.9
Dividend (%) 21.3

P/E using TTM EPS 14.6
P/E using 2015 Estimate 15.1
P/E using 2016 Estimate 13.4
Zacks Rank *: Short Term 3 - Hold

* Definition / Disclosure on last page

ZACKS CONSENSUS ESTIMATES

Revenue Estimates
(In millions of $)

<table>
<thead>
<tr>
<th>Q1 (Dec)</th>
<th>Q2 (Mar)</th>
<th>Q3 (Jun)</th>
<th>Q4 (Sep)</th>
<th>Year (Sep)</th>
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<tbody>
<tr>
<td>2013</td>
<td>6,018 A</td>
<td>6,124 A</td>
<td>6,243 A</td>
<td>6,480 A</td>
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<tr>
<td>2014</td>
<td>6,622 A</td>
<td>6,367 A</td>
<td>6,806 A</td>
<td>6,692 A</td>
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<tr>
<td>2015</td>
<td>6,968 E</td>
<td>6,784 E</td>
<td>6,933 E</td>
<td>7,254 E</td>
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<tr>
<td>2016</td>
<td></td>
<td></td>
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Earnings Per Share Estimates
(EPS is operating earnings before non-recurring items, but including employee stock options expenses)

<table>
<thead>
<tr>
<th>Q1 (Dec)</th>
<th>Q2 (Mar)</th>
<th>Q3 (Jun)</th>
<th>Q4 (Sep)</th>
<th>Year (Sep)</th>
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<tr>
<td>2013</td>
<td>$1.14 A</td>
<td>$1.05 A</td>
<td>$0.92 A</td>
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<td>$1.13 A</td>
<td>$1.20 A</td>
<td>$1.34 A</td>
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<tr>
<td>2015</td>
<td>$1.10 E</td>
<td>$1.14 E</td>
<td>$1.16 E</td>
<td>$1.25 E</td>
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<tr>
<td>2016</td>
<td></td>
<td></td>
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</tr>
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</table>

Projected EPS Growth - Next 5 Years % 13

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10 S. Riverside Plaza, Chicago IL 60606
Qualcomm Inc. (QCOM), designs, manufactures, and markets digital wireless telecom products and services based on the Code Division Multiple Access (CDMA) technology. The products include CDMA-based integrated circuits (ICs) and system software for wireless voice and data communications as well as global positioning system (GPS) products. The company also licenses many of its 5,700+ patents and intellectual property to wireless equipment manufacturers. Qualcomm usually receives one-time license fees and ongoing royalties from companies using CDMA technology and associated protocols. Qualcomm's business is organized into two reporting segments as follows:

- **Qualcomm CDMA Technologies (QCT):** This segment reports operating results for sales of CDMA-based integrated circuit devices (chips) and system software for wireless voice and data communications, as well as GPS products. QCT's integrated circuit (IC) products are used mainly in mobile phones, wireless data access cards, and infrastructure equipment. QCT offers a broad portfolio of products that support CDMA2000 1X, 1xEV-DO, EV-DO Revision A, EV-DO Revision B and UMB. Qualcomm also develops IC that supports GSM/GPRS, WCDMA, HSDPA and HSUPA technologies. QCT accounted for nearly 67.2% of the total revenue in fiscal 2013.

- **Qualcomm Technology Licensing (QTL):** This segment reports revenues received from licenses to the intellectual property portfolio, which includes CDMAOne, CDMA2000 1X EV-DO/1xEV-DV, TD-SCDMA, and WCDMA technology solutions. QTL generates revenues from license fees as well as royalties based on global sales by licensees of products incorporating or using Qualcomm's intellectual property. QTL generated approximately 30.4% of the total revenue in fiscal 2013.

**REASONS TO BUY**

- Qualcomm is the undisputed leader in the global wireless baseband chipset market. At present, Qualcomm dominated this market with approximately 66% of revenue share, followed by 15% of Mediatek Inc. and 5% of Spreadtrum Communications. Recently, Gartner reported that Qualcomm is the third largest global player in the overall (including mobile handset, laptop and PC) semiconductor market with an estimated 5.5% share after 15.4% share of Intel and 9.7% share of Samsung. Qualcomm benefits from the significant growth of 3G/4G LTE wireless technologies and smartphones in the emerging markets, particularly in China. Moreover, growing deployment of 4G Long Term Evolution (LTE) technology in China may further drive Qualcomm's chip demand. The company is a major chipset provider to Apple and Samsung, which together constitute 40% of the smartphone and 50% of the tablet market, globally. In addition, Qualcomm's Gobi mobile Internet connectivity solutions will provide 3G/4G LTE connectivity to devices that will run on the Windows 8 software. Qualcomm is the sole chipset developer for both Windows-based smartphones and notebooks.

- Qualcomm currently has more than 255 royalty bearing licensees worldwide. Additionally, the company has over 90 single-mode OFDMA licensees. Qualcomm has introduced its next-generation processors called Snapdragon 600 and 800. These chipsets provide 40–75% better performance than the S4 Pro series and are the first to operate on the TSMC 28nm technology. Qualcomm further unveiled Snapdragon 808 and 810, which are capable of delivering download speeds of up to 300 mbps, high-definition images, 4K video recording support and ultra-high resolution playback. Both the chips are powered with 64-bit computing capacity, which are generally used in PCs. Smartphones integrated with the latest Snapdragon 808 and 810 processors are slated to be available from early 2015. The company has launched its innovative RF360 Front End Solutions which resolves LTE fragmentation faced by most of the large handset manufacturers. Qualcomm has provided the chipset and modem for world's first commercially available LTE-A (Long-Term
Evolution Advanced) Category 6 (Cat 6) smartphone. Qualcomm’s Snapdragon 805 processor and Gobi 9x35 modem are jointly providing the basic technology and connectivity in Samsung’s Galaxy S5 broadband LTE-A Cat 6 smartphone in South Korea.

- During the fourth quarter of fiscal 2014, Qualcomm shipped approximately 236 million CDMA-based MSM chipsets, up by a whopping 24% year over year. However, this figure was way below the company’s guidance of a mid-point of 237.5 million. Average selling price (ASP) of mobile handsets, with an in-build Qualcomm chipset, during the quarter stood around $220–$226. In the first quarter of fiscal 2015, Qualcomm expects to ship between 250 and 270 million MSM chipsets, which is higher the count reported in the third quarter. We expect Qualcomm to benefit considerably as the company boasts an extensive five-mode LTE chipset portfolio developed on its baseband technology. The five-mode standard includes LTE, FDD-LTE, TD-SCDMA, WCDMA and GSM.

- Qualcomm has taken two significant steps to develop advanced WiFi chipsets utilizing the super fast 60GHz technology. Management stated that these two strategic decisions will completely overhaul the existing WiFi ecosystem for mobile, computing and networking devices. First, the company has acquired Wilocity Ltd., a leading Israeli developer of 60 GHz wireless chipsets based on IEEE 802.11ad standard, popularly known as WiGig technology. Second, Qualcomm is in the process to develop a tri-band platform that will integrate its WiFi technology from the previously acquired Atheros Communications Inc. with the newly acquired WiGig solutions to significantly enhance the performance of wireless applications.

- Qualcomm has also acquired Black Sand Technologies, a leading fabless semiconductor manufacturer. Black Sand deploys its flagship CMOS semiconductor technology to develop advanced power amplifiers for wireless applications. The company’s advanced technology combines sensitive analog and powerful digital circuits in silicon. Furthermore, Black Sand has the industry’s largest patent portfolio of IP-based mixed-signal technology. Earlier, Qualcomm unveiled an innovative smartwatch called “Toq”. This smartwatch can simultaneously receive phone calls, send messages and play music.

- In Jan 2014, Qualcomm acquired a portfolio of patents from Hewlett-Packard for an undisclosed amount. The portfolio comprises 1,400 granted and pending patent applications from the U.S. and about 1,000 granted and pending patent applications from countries like China, England, Germany, Japan and South Korea. The patent portfolio covers a wide range of technologies that include fundamental mobile operating system techniques. Acquisition of this patent portfolio will enable Qualcomm to expand into the global mobility market more aggressively.

**REASONS TO SELL**

- Qualcomm is currently in deep trouble in China. On Nov 2013, the Chinese regulatory authority, National Development and Reform Commission (NDRC), had initiated a probe on the company related to its monopolistic practice. A state-run Chinese newspaper stated that the NDRC has determined that Qualcomm is exercising monopoly power in that country. Qualcomm stated that it isn’t aware of any activity that violates the anti-monopoly law in China and will continue to cooperate with the NDRC. Qualcomm has issued a cautious outlook for fiscal 2015 citing the ongoing licensing business issue in China as a major factor likely to impact profitability in the near term.

- Qualcomm is currently involved in a royalty dispute with a major customer in China. Moreover, some small companies haven’t agreed on a royalty payment as the NDRC is yet to come up with its decision. A few companies are also under-reporting the amount of phones sold, for which they should have ideally paid license fees. Meanwhile, the low-end 3G tablets are gaining huge market
traction in China. However, tablet developers are completely different from smartphone developers in China. For that, Qualcomm needs to enter into new licensing agreement with them.

- China is a major growth driver for the company owing to its large population and increasing adoption of 4G LTE technology. Qualcomm generates approximately 29% of its total revenues from the licensing business however, this business accounts for almost 77% of the company's net profit. China contributed approximately 49% of Qualcomm's total revenue in fiscal 2014. Some analysts projected that if found guilty, Qualcomm may need to pay a significant $1.2 billion or more in fine. More importantly, the company might also have to forego royalties of TDD-LTE as a settlement. Such unfavorable actions will severely impair Qualcomm's patent portfolio.

- Additionally, Qualcomm also declared that the company is also facing a fresh regulatory investigation in U.S and Europe. The European Commission is investigating rebates and other financial incentives related to the sale of the company's chips, whereas the U.S. Federal Trade Commission is doing an initial inquiry on Qualcomm's licensing terms.

- Qualcomm is facing two patent litigation cases from ParkerVision Inc. In 2011, ParkerVision claimed that Qualcomm had violated its patents associated with the conversion mechanism of electromagnetic signals from higher frequencies to lower frequencies. Recently, a federal judge of U.S. District Court for the Middle District of Florida has delivered verdict in favor of Qualcomm. However, ParkerVision has decided to seek a review of the judgment. Moreover, the second case involves a more complex technology which includes patents related to the technology of mobile device's information sharing with a wireless tower.

- Aggressive competition in the mobile phone chipset market may hurt Qualcomm's profits in the future. The company is facing severe competitive threat from its closest rival, Intel, which has been redesigning its chipsets for the mobile computing market. Intel started delivering multi-mode LTE baseband modem. Competition is also likely to emanate from formidable rivals like Broadcom and Nvidia. Broadcom already introduced its LTE baseband chipset in the market while Nvidia launched Tegra 4i, its LTE-integrated application processor. Also, opposition emanates from low-cost chip suppliers like Mediatek of Taiwan, VIA Technologies of China and Spreadtrum Communications. Although, the global smartphone market is expected to maintain its momentum in the next 4-5 years, the major part of this growth is likely to come from the low-cost emerging markets, which may pressurize Qualcomm’s margins.

**RECENT NEWS**

**Fourth Quarter of Fiscal 2014 Financial Results – Nov 5, 2014**

**Qualcomm Underperforms**

On a GAAP basis, quarterly net income from continuing operations stood at $1,894 million or $1.11 per share compared with $1,501 million or $0.86 per share in the year-ago quarter. However, adjusted (excluding special items) earnings per share came in at $1.14, lagging the Zacks Consensus Estimate of $1.20. Adjusted earnings per share increased 25.2% year over year. Quarterly total revenue of $6,692 million was up 3% year over year but lagged the Zacks Consensus Estimate of $7,005 million. Segment wise, Qualcomm CDMA Technologies businesses contributed $4,849 million of revenues in the fourth quarter, up 9% over the prior-year period. Meanwhile, quarterly EBT margin was 22%. Qualcomm Technology Licensing generated $1,795 million in revenues, down 4% year over year. Quarterly EBT margin was 86%.

**Operating Metrics**
Adjusted quarterly operating income came in at $2,323, up 20% year over year. Gross margin was 58.8% as against 58.1% in the year-ago quarter. Adjusted quarterly operating margin was 34.7% compared with 29.9% in the prior-year quarter.

Other Financial Aspects

During the fourth quarter, Qualcomm generated $1,619 million of cash from operations compared with $2,523 million in the prior-year period. Free cash flow in the quarter was $1,389 million against $2,323 million a year ago. At the end of fiscal 2014, Qualcomm had $32 billion of cash and marketable securities and no outstanding debt on its balance sheet compared with $29.4 billion of cash and marketable securities and zero outstanding debt at the end of fiscal 2013. On Oct 16, Qualcomm declared a quarterly cash dividend of $0.42 per share payable on Dec 18, to shareholders of record at the close of business on Dec 1, 2014.

Guidance at Glance

First-quarter fiscal 2015 revenues are expected in the range of $6.6–$7.2 billion. GAAP earnings per share are projected to be $1.00–$1.12. Non-GAAP earnings per share are likely to range between $1.04 and $1.16 including $0.14 per share of stock-based compensation expenses. Also, Qualcomm is expected to ship 250–270 million MSM chipsets in the first quarter.

Fiscal 2015 total revenue guidance is estimate to be in the range of $26.8–$28.8 billion. GAAP earnings per share are projected to be in the range of $4.33 and $4.63. Non-GAAP earnings per share are forecasted in the band of $4.50–$4.80, including $0.55 per share of stock-based compensation expenses.

VALUATION

Qualcomm is at present trading at 15.1x our fiscal 2015 earnings estimate, which is at a massive discount to both the industry average and the S&P 500. With respect to our forward fiscal 2016 earnings estimate, the stock is currently trading at 13.4x, this is also at a huge discount to the industry average but nearly at par with the S&P 500. In our view, the company is in a position to benefit over time, as the demand for high-end smartphones and tablets are increasing gradually, supported by rapid deployment of 3G and super-fast 4G networks throughout the world. Qualcomm has a diversified product portfolio, a powerful pipeline full of innovative products and a solid list of clientele. Nevertheless, we believe that the stock is currently fairly valued and will not provide above-market gain anytime soon. We, therefore, maintain our Neutral recommendation with a target price of $74, based on 15.9x our fiscal 2015 earnings estimate, approaching the S&P 500.
### Key Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>QUALCOMM INC (QCOM)</th>
<th>Industry Average</th>
<th>S&amp;P 500</th>
<th>ERICSSON LM ADR (ERIC)</th>
<th>AIRSPAN NETWRKS (AIRO)</th>
<th>NOKIA CP-ADR A (NOK)</th>
<th>ZTE CORP U-ADR (ZTCOY)</th>
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<tbody>
<tr>
<td>P/E F1</td>
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<td>24.4</td>
<td>16.8</td>
<td>17.9</td>
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<td>P/E F2</td>
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<td>20.9</td>
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<td>4.2</td>
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<td>Est. 5-Yr EPS Gr%</td>
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<td>10.7</td>
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<td>11.5</td>
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<tr>
<td>P/CF (TTM)</td>
<td>13.2</td>
<td>27.6</td>
<td>15.7</td>
<td>8.9</td>
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<td>P/E 5-Yr Low (TTM)</td>
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TTM is trailing 12 months; F1 is 2015 and F2 is 2016, CF is operating cash flow

<table>
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<th>Indicator</th>
<th>QUALCOMM INC (QCOM)</th>
<th>Industry Average</th>
<th>S&amp;P 500</th>
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<td>P/B 5-Yr High</td>
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<td>9.8</td>
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<td>P/B 5-Yr Low</td>
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<td>ROE (TTM)</td>
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<td>EV/EBITDA (TTM)</td>
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**Notes:**
- P/E: Price-to-Earnings
- P/CF: Price-to-Operating Cash Flow
- EPS Gr%: Earnings Per Share Growth
- ROE: Return on Equity
- D/E: Debt-to-Equity
- Div Yield: Dividend Yield
Earnings Surprise and Estimate Revision History

GMP ACM INC (W)

↑ ↓ EPS Surprises

Price

QUALCOMM INC (W)

Price

EPS ($/sh)

2015 Consensus

2014 Consensus

2013 Consensus

2012 Consensus

2011 Consensus

Price ($)

3/2/10
8/17/10
2/1/11
7/19/11
1/3/12
6/19/12
12/4/12
5/21/13
11/5/13
4/22/14
10/7/14
12/16/14

<< 1/17/94

<< 1/3/03

<< 12/16/14 >>

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Equity Research

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DISCLOSURES & DEFINITIONS

The analysts contributing to this report do not hold any shares of QCOM. The EPS and revenue forecasts are the Zacks Consensus estimates. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts’ personal views as to the subject securities and issuers. Zacks certifies that no part of the analysts’ compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report. Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Because of individual objectives, the report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed herein are subject to change. This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. Zacks uses the following rating system for the securities it covers. **Outperform**: Zacks expects that the subject company will outperform the broader U.S. equity market over the next six to twelve months. **Neutral**: Zacks expects that the company will perform in line with the broader U.S. equity market over the next six to twelve months. **Underperform**: Zacks expects the company will underperform the broader U.S. Equity market over the next six to twelve months. The current distribution of Zacks Ratings is as follows on the 1139 companies covered: Outperform - 16.2%, Neutral - 77.5%, Underperform – 6.0%. Data is as of midnight on the business day immediately prior to this publication.

Our recommendation for each stock is closely linked to the **Zacks Rank**, which results from a proprietary quantitative model using trends in earnings estimate revisions. This model is proven most effective for judging the timeliness of a stock over the next 1 to 3 months. The model assigns each stock a rank from 1 through 5. Zacks Rank 1 = Strong Buy, Zacks Rank 2 = Buy, Zacks Rank 3 = Hold, Zacks Rank 4 = Sell. Zacks Rank 5 = Strong Sell. We also provide a **Zacks Industry Rank** for each company which provides an idea of the near-term attractiveness of a company's industry group. We have 264 industry groups in total. Thus, the Zacks Industry Rank is a number between 1 and 264. In terms of investment attractiveness, the higher the rank the better. Historically, the top half of the industries has outperformed the general market. In determining **Risk Level**, we rely on a proprietary quantitative model that divides the entire universe of stocks into five groups, based on each stock's historical price volatility. The first group has stocks with the lowest values and are deemed **Low Risk**, while the 5th group has the highest values and are designated **High Risk**. Designations of **Below-Average Risk**, **Average Risk**, and **Above-Average Risk** correspond to the second, third, and fourth groups of stocks, respectively.