Qualcomm's Nightmare Continues as U.S. Regulators Slam ZTE

The chipmaker gets caught in the crossfire again.

Leo Sun **Apr 20, 2018 at 9:04PM**

China has been a tough market for **Qualcomm** (NASDAQ:QCOM) over the past few years. Chinese regulators fined the chipmaker nearly $1 billion in late 2015 over its licensing practices, and forced it to lower its licensing fees for Chinese OEMs. Even then, some Chinese OEMs allegedly underreported their shipments to pay lower licensing fees, forcing Qualcomm to sign new licensing agreements with each device maker.

Qualcomm's long-delayed takeover of **NXP Semiconductors** (NASDAQ:NXPI) remains in limbo as China's Ministry of Commerce takes its time with its decision. Qualcomm tried to curry the favor of the Chinese government by working with Chinese companies to develop new chips for connected cars, Internet of Things (IoT) devices, and 5G technologies. Unfortunately, President Trump then proposed tough tariffs against China, turning Qualcomm into a potential target for retaliation from Chinese regulators.

Those headwinds were already brutal, but the U.S. Department of Commerce recently dealt Qualcomm another blow by banning all component shipments from American companies to Chinese telecom giant **ZTE** (NASDAQOTH:ZTCOY) for seven years. ZTE was found guilty of violating trade sanctions by shipping products to Iran, and pleaded guilty to the charges in late March.

Why the ZTE ban hurts Qualcomm

ZTE sells a wide variety of communication devices, including telecommunications gear, networking equipment, and smartphones. The company shipped an estimated 46.4 million smartphones last year, according to **IHS Markit**. Qualcomm, the largest mobile chipmaker in the world, supplies chips to "almost half" of those devices, according to Counterpoint Research's Neil Shah. Shah estimates that at about $25 per chip, Qualcomm generates "close to half a billion dollars" in annual revenues from ZTE. Research firm Canalys estimates that Qualcomm supplies chips for 65% of ZTE's smartphones.

Analysts expect Qualcomm's revenue to fall 4% to $22.2 billion this year, so ZTE orders of $500 million would be about 2.2% of that. That blow seems manageable, but it comes at a terrible time for Qualcomm. Qualcomm's chipmaking business, which generates most of its revenues, is being challenged by cheaper chipmakers and first party OEMs like **Huawei**. Its licensing business, which generates most of its profits, is being targeted by regulators and OEMs, which claim that its fees are too high.

The decision to block Qualcomm from supplying chips to ZTE also leaves the door wide open for rival chipmakers like Taiwan's **MediaTek** and China's own **HiSilicon** (a subsidiary of Huawei) to fill the void. **Samsung** (NASDAQOTH: SSNLF), which has been itching to sell its Exynos SoCs to third-party device makers, could also swoop in.

ZTE's Axon M. Image source: ZTE.

Between the third quarters of 2016 and 2017, Qualcomm's market share in application processors rose from 41% to 42%, according to Counterpoint. But with the loss of ZTE, its year-over-year growth could reverse.

A weird move that helps Chinese chipmakers

The ZTE ban is an odd move that hurts American companies while helping Chinese ones. The ban already crushed the stock price of U.S. fiber optic companies like **Acacia Communications** (NASDAQ: ACIA), which generated 30% of its sales from ZTE's orders last year.

Locking out companies like Qualcomm and Acacia merely encourages ZTE to order more components from Chinese manufacturers. Other Chinese OEMs, realizing that their supply of American components could be abruptly cut off, would likely do the same.

The Chinese government, which is already focused on reducing the company's dependence on foreign technologies, will likely pour more money into domestic chipmakers to aid major companies like ZTE. Meanwhile, American companies might think twice before accepting bulk orders from Chinese OEMs.

What's next for Qualcomm?

Qualcomm has a lot on its plate right now. It's still reeling from Broadcom's blocked bid, its legal battles against **Apple** are escalating, the future of the NXP deal remains murky, and its former CEO is reportedly trying to take the company private.

The Commerce Department's decision to block U.S. companies from supplying components to ZTE marks another escalation of trade tensions between the U.S. and China. Qualcomm, once again, is stuck in the crossfire and forced to deal with the consequences.

Former Qualcomm chairman Paul Jacobs is assembling a group of buyers to take it private

Alex Sherman

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Paul Jacobs, who was ousted as Qualcomm's chairman in March, is talking to strategic investors and sovereign wealth funds to chip in for a fully financed bid to take Qualcomm private in the next two months, according to people familiar with the plan. He would run the company after it's gone private.

One of the potential investors is mobile chip designer ARM, which SoftBank bought in 2016 for more than $30 billion, these people said. ARM's technology forms the basis for most processors used in smartphones and tablets, including Qualcomm's processors.

ARM denied that it has talked to Jacobs about a possible acquisition involving Qualcomm. " "There have been no discussions between Arm and Paul Jacobs on any potential acquisition of Qualcomm," a spokesperson said.

Jacobs has hired two banks and lawyers to work on the deal, the people said.

When the deal is completed, he is hoping for fewer than ten owners to be involved. Economic ownership might not align with control of the company. Jacobs, himself, owns less than 1 percent of Qualcomm.

Control will remain in the United States under Jacobs' plan, which he believes would allow the deal to avoid the kind of scrutiny that sank Broadcom's attempt to buy Qualcomm for around $120 billion. President Trump blocked that deal in March after the Committee on Foreign Investment in the United States expressed concerns over potential national security risks. Broadcom was based in Singapore, but has since re-domiciled to the United States.

Still, Jacobs has been working with CFIUS behind the scenes to address potential problems, which theoretically could arise if a large amount of the economic ownership comes from foreign sovereign wealth funds. The SoftBank-controlled Vision Fund includes a major investment from Saudi Arabia's main sovereign wealth fund.

A person familiar with his thinking says Jacobs does not believe Qualcomm should be carved up, but he believes he can only implement his plan for it as a private company, because that plan will require significant investment and things that public shareholders would not like.

Jacobs' father, Irwin, was a co-founder of Qualcomm, and Paul Jacobs rose through the ranks to become CEO from 2005 through 2014. Steve Mollenkopf has been CEO since then, while Jacobs served as chairman. The board removed him in March after Jacobs informed them of his desire to take the company private.

The company has been involved in a complicated high-stakes legal dispute with Apple, which licenses core wireless technology from Qualcomm. Apple claims that the company overcharges for licenses and has sued it for patent infringement, while Qualcomm has sought to have Apple phones banned from China, among other things. Jacobs plans to settle the dispute with Apple
and rely on his strong relationship with Tim Cook, the people said.

Jacobs plans to maintain Qualcomm's license business, unlike Broadcom, which would have shut that piece down, the people said. Jacobs feels the licensing business is actually the strongest part of Qualcomm if operated correctly, the people said.

https://www.cnbc.com/2018/04/12/paul-jacobs-assembling-a-group-of-buyers-to-take-qualcomm-private.html

Qualcomm Fined $1.2 Billion as Apple Loyalty Comes at a Price

by Aoife White January 24, 2018, 6:14 AM MST

Qualcomm Inc. spent billions of dollars buying Apple Inc.'s loyalty.

It must now shell out 997 million euros ($1.2 billion) in fines after the European Union's antitrust arm said the payments were an illegal ploy to ensure only its chips were used in iPhones and iPads. Apple was cornered by Qualcomm with a 2011 deal that offered "significant" sums and rebates if it only bought the company's chips, the European Commission said in an emailed statement.

"Apple was seriously thinking of switching" from Qualcomm to Intel chips "which would have made a big difference to Intel" but couldn't do so until its Qualcomm pact was about to expire in September 2016, EU Competition Commissioner Margrethe Vestager told reporters at a Brussels press conference.

"This meant that no rival could effectively challenge Qualcomm in this market, no matter how good their products were," Vestager said. "We're talking about one of the biggest and most important customers in this market."

The antitrust fine, the EU's third highest, comes as Qualcomm tries to fend off a $105 billion hostile takeover by rival Broadcom Ltd. and wages war with Apple in numerous court cases around the world over patent licensing. Qualcomm's management is under pressure to show shareholders it can manage the Apple dispute and battles with regulators that have already led to fines in China and South Korea.

Qualcomm Appeal

"Qualcomm strongly disagrees with the decision and will immediately appeal it to the General Court of the European Union," the company said in a statement. The EU decision "does not relate to Qualcomm's licensing business and has no impact on ongoing operations."

Shares in Qualcomm fell 1.2 percent in pre-market trading in New York.

"This is a huge fine by any standards and shows that Commissioner Vestager is starting 2018 very aggressively," said Assimakis Komninos, a lawyer at White & Case in Brussels.

4G Phones

The case focuses on LTE baseband chipsets used in the 4G mobile phone standard. Qualcomm warned Apple that it would cease payments if it sold products using other chips. Vestager said this threat was a key factor for Apple refusing to source from Intel. "It would have cost Apple a lot of money" to quit Qualcomm and it "would have made a big difference to Intel."

"The outcome is that rivals are prevented from challenging dominant companies with more innovative products," Vestager said. The fine represents 4.9 percent of Qualcomm's revenue in 2017, the EU said.

Vestager said the decision sends a warning to other companies that would contemplate using similar practices: "Don't go there."

Apple declined to immediately comment. Intel declined to comment.

Qualcomm faces a threat of further fines from a second EU investigation into allegations it deliberately sold internet modem chips below cost from 2009 to 2011 to knock out a rival. EU officials "are still at it with a priority," Vestager said of that case. The EU alleges that Qualcomm aimed to hinder competitor Icera, now owned by Nvidia Inc. That case has escalated with a court dispute over information the EU sought from the company. Qualcomm was threatened with additional daily fines for not quickly supplying data the EU wanted.

Apple in Clear

There are "no repercussions" for Apple for accepting the deal with Qualcomm and no evidence of wrongdoing by the Cupertino, California-based company, Vestager said.

Wednesday's decision has parallels with the EU's 2009 finding that Intel's rebates to computer manufacturers and payments to a retailer were aimed at squeezing out a smaller chipmaker.

It's the first time the EU has landed a blow on Qualcomm, nearly a decade after officials dropped a four-year probe in 2009 into how it licensed patents used in the 3G phone standard. There was no fine or any finding that Qualcomm violated antitrust rules in that case.

Apple and Qualcomm have been waging legal battles over the world about the fees Qualcomm charges for its chip designs. Apple says Qualcomm charges too much and is leveraging its strong market position in chips illegally. Qualcomm counters that Apple, one of its largest customers, has lied to regulators in an unfair attempt to bully it into charging less.

— *With assistance by Nikos Chrysoloras, Chris Elser, and Giles Turner*

Qualcomm to pay $975 million to resolve China antitrust dispute

FEBRUARY 9, 2015 / 8:04 PM / 3 YEARS AGO

Noel Randewich

SAN FRANCISCO/BEIJING (Reuters) - Qualcomm Inc has agreed to pay a fine of $975 million, the largest in China's corporate history, ending a 14-month government investigation into anti-competitive practices.

A Qualcomm sign is pictured in front of one of its many buildings in San Diego, California November 5, 2014. REUTERS/Mike Blake

The deal - the details of which were first reported by Reuters on Monday - also requires Qualcomm to lower its royalty rates on patents used in China, likely helping local smartphone makers such as Xiaomi Technology Co Ltd [XTC.UL] and Huawei Technologies Co Ltd [HWT.UL].

Qualcomm said the agreement removes a major source of concern for its investors, sending shares of the San Diego-based chipmaker up 2.8 percent to $69 in after-hours trading.

China's expanding high-speed 4G network is driving demand for smartphones with leading-edge technology, but Qualcomm's opportunities have been clouded by the antitrust probe, which has also contributed to problems in collecting royalty payments from device makers.

Qualcomm said in a statement on Monday it would not contest the National Development and Reform Commission's (NDRC) finding that it violated an antitrust law.

Asked whether the resolution in China could affect the outcome of ongoing antitrust probes into Qualcomm in Europe and the United States, Qualcomm President Derek Aberle said, "We fully respect their authority, but we don't believe it's likely that other agencies will necessarily meet similar conclusions."

The U.S. firm cut its full-year earnings estimate, putting the cost of the fine at about 58 cents per share, but it raised the lower end of its revenue forecast slightly.

"It removes a significant source of uncertainly from our business and positions our licensing group to really participate in the full growth of the wireless market in China," CEO Steve Mollenkopf said in a phone interview. "It's something we're happy is over."

FINE COULD HAVE BEEN HIGHER

Discussions in Beijing over one of the most contentious cases under China's 2008 anti-monopoly law had intensified in recent weeks, culminating in meetings between Qualcomm senior executives and the NDRC on Friday.

Xu Kunlin, head of the NDRC's anti-monopoly bureau, said the $975 million fine - equal to 8 percent of Qualcomm's 2013 sales in China - was less than the 10 percent of sales maximum allowed under Chinese law because Qualcomm fully cooperated with investigators.

"Issuing the fine was not our primary purpose," Xu told reporters on Tuesday, according to a Sina.com live-blog of his remarks. "Our purpose was to restore orderly, free-market competition. Qualcomm's practices had stifled innovation."

Under the terms of the agreement, Qualcomm will offer licenses to its current 3G and 4G essential Chinese patents, widely used by Chinese device makers, separately from other patents. For companies opting for the new agreement, which applies to phones sold for use in China, Qualcomm will calculate royalties based on 65 percent of the phone's selling price, instead of on the whole price.

Some on Wall Street have speculated that even limited concessions made to Qualcomm's licensing business in China could affect the technology company's licensing deals elsewhere.

"That's the first time I've ever seen them in writing agree to that and it begs the question of why 65 percent is the right number in China and it's not the right number everywhere," said Bernstein analyst Stacy Rasgon.

As a result of the fine, Qualcomm said it now expects full-year earnings per share of $3.56-$3.76 for fiscal 2015, compared with a prior forecast of $4.04-$4.34. It raised its fiscal 2015 revenue forecast to $26.3-$28 billion, slightly raising the lower end of its previous forecast of $26-$28 billion.

Excluding the cost of the fine and other one-time items, Qualcomm forecast earnings of $4.85-$5.05 per share, raising the lower end of its previous forecast of $4.75-$5.05. On that basis, analysts had expected $4.96 per share, on average, according to Thomson Reuters I/B/E/S.

Qualcomm is one of several overseas companies, including Microsoft Corp, to come under investigation in China for allegedly anti-competitive practises.

Additional reporting by Bill Rigby in Seattle and Gerry Shih in Beijing; Editing by Lisa Shumaker and Ian Geoghegan

Qualcomm faces $774 million antitrust fine in Taiwan

Jon Fingas, @jonfingas
10.11.17

Qualcomm's antitrust troubles aren't going away any time soon. Taiwan's Fair Trade Commission has fined the company the equivalent of $774 million over claims it abused its dominance of cellular chipsets in phones.

The company effectively has a monopoly over CDMA, WCDMA (3G) and LTE chipsets, the Commission said, and it refuses to properly license its technology to others. Accordingly, the penalty will also have Qualcomm submit twice-a-year reports on negotiations with other companies.

Qualcomm, not surprisingly, disagrees with the decision. It plans to call for a stay on "any required behavioral measures" and will appeal the FTC's action in Taiwanese courts. The fine has "no rational relationship" to Qualcomm's actual revenues in Taiwan, the company said.

The fine comes on top of an existing $854 million fine in South Korea, a $975 million fine in China as well as lawsuits from Apple and the FTC.

While Qualcomm can likely handle the financial penalties, it's the crackdown on behavior that will likely give it the most grief. It has regularly accused phone makers and others of refusing to pay what it expects for patent licenses, and the antitrust actions could easily force it to accept far less favorable terms. And when Taiwan is one of the world's more important cellphone markets (it's the home base for firms like ASUS and HTC), Qualcomm doesn't have much choice but to play along.

Revenue Recognition. The Company derives revenues principally from sales of integrated circuit products and licensing of its intellectual property and also generates revenues through sales of products that connect medical devices and by performing software hosting, software development and other services. The timing of revenue recognition and the amount of revenue actually recognized in each case depends upon a variety of factors, including the specific terms of each arrangement and the nature of the Company's deliverables and obligations. Unearned revenues consist primarily of license fees for intellectual property with continuing performance obligations.

Revenues from sales of the Company's products are recognized at the time of shipment, or when title and risk of loss pass to the customer and all other criteria for revenue recognition are met, if later. Revenues from providing services are recognized when earned. Revenues from providing services were less than 10% of total revenues for all periods presented.

The Company grants licenses or otherwise provides rights to use portions of its intellectual property portfolio, which, among other rights, includes certain patent rights essential to and/or useful in the manufacture and sale of certain wireless products. Licensees typically pay a fixed license fee in one or more installments and royalties based on their sales of products incorporating or using the Company's licensed intellectual property. License fees are recognized over the estimated period of benefit of the license to the licensee, typically 5 to 15 years. Royalties are generally based upon a percentage of the wholesale (i.e., licensee's) selling price of complete licensed products, net of certain permissible deductions (including transportation, insurance, packing costs and other items). The Company broadly provides per unit running royalty caps that apply to certain categories of complete wireless devices, namely smartphones, tablets and laptops, which in general, effectively provide for a maximum running royalty amount per device (i.e., the royalty caps limit the running royalties due on a per unit basis). The Company earns royalties on such licensed products sold worldwide by its licensees at the time that the licensees' sales occur. The Company's licensees, however, do not report and pay royalties owed for sales in any given quarter until after the conclusion of that quarter, which is generally the following quarter. The Company recognizes royalty revenues based on royalties reported by licensees during the quarter and when all other revenue recognition criteria are met.

The Company records reductions to revenues for customer incentive arrangements, including volume-related and other pricing rebates and cost reimbursements for marketing and other activities involving certain of the Company's products and technologies. The charges for such arrangements are recorded as a reduction to accounts receivable or as other current liabilities based on whether the Company has the contractual right of offset. The Company recognizes the liability based on the estimated amount of the incentive, or if not reasonably estimated, the maximum potential liability, at the later of the date at which the Company records the related revenues or the date at which the Company offers the incentive or, if payment is contingent, when the contingency is resolved. In certain arrangements, the liabilities are based on customer forecasts. The Company reverses accruals for unclaimed incentive amounts to revenues when the unclaimed amounts are no longer subject to payment.

Concentrations. Revenues in fiscal 2017 were negatively impacted by the actions of Apple Inc. and Hon Hai Precision Industry Co., Ltd./Foxconn, its affiliates and other suppliers to Apple as well as the dispute with another licensee, who did not report or pay royalties due in the third or fourth quarter of fiscal 2017. Apple's contract manufacturers did not fully report and did not pay royalties due on sales of Apple products for a portion of the fiscal year, which resulted in higher accounts receivable from those suppliers (Note 2). A significant portion of the Company's revenues is concentrated with a small number of customers/licensees of the Company ' s QCT and QTL segments. Revenues related to the products of two customers/licensees comprised 18% and 17% of total consolidated revenues in fiscal 2017 , compared to 24% and 16% in fiscal 2016 and 25% and 20% in fiscal 2015 . Excluding the unpaid royalty receivables due from suppliers to Apple (Note 2), aggregate accounts receivable from one customer/licensee comprised 10% and 14% of accounts receivable at September 24, 2017 and September 25, 2016 , respectively.

The Company relies on sole- or limited-source suppliers for some products, particularly products in the QCT segment, subjecting the Company to possible shortages of raw materials or manufacturing capacity. While the Company has established alternate suppliers for certain technologies that the Company considers critical, the loss of a supplier or the inability of a supplier to meet performance or quality specifications or delivery schedules could harm the Company's ability to meet its delivery obligations and/or negatively impact the Company's revenues, business operations and ability to compete for future business.