



Qualcomm Inc (QCOM)

Updated August 1st, 2018 by Nate Parsh

Key Metrics

Current Price: \$64	5 Year CAGR Estimate: 3.3%	Volatility Percentile: 84.1%
Fair Value Price: \$51	5 Year Growth Estimate: 4.0%	Momentum Percentile: 74.2%
% Fair Value: 125%	5 Year Valuation Multiple Estimate: -4.6%	Valuation Percentile: 19.4%
Dividend Yield: 3.9%	5 Year Price Target: \$60	Total Return Percentile: 15.5%

Overview & Current Events

“Quality Communications” was started in the living room of Dr. Irwin Jacobs in 1985. The company’s first product and service was a satellite used by long-haul trucking companies that could locate and message drivers. Qualcomm, as it is known today, develops and sells integrated circuits for use in voice and data communications. The chip maker receives royalty payments for its patents used in devices that are on 3G and 4G networks. Qualcomm has a current market capitalization of \$91.1 billion and generated sales of more than \$23 billion in 2017.

Qualcomm reported 3rd quarter earnings for fiscal 2018 on July 25th. The company earned \$1.01 per share, \$0.30 above estimates and 21.7% above last year’s results. Revenue grew 5.7% to \$5.6 billion, \$410 million above expectations.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.25	\$1.90	\$2.46	\$3.20	\$3.71	\$4.51	\$5.27	\$4.66	\$4.44	\$4.28	\$3.61	\$4.39
DPS	\$0.60	\$0.66	\$0.72	\$0.81	\$0.93	\$1.20	\$1.54	\$1.80	\$2.02	\$2.20	\$2.43	\$2.96

Qualcomm’s earnings per share declined almost 16% during the last recession. Even with this sharp decline, the company has grown earnings per share at a rate of 6.6% per year over the last decade. Much of this growth has taken place in the early part of the current decade as royalty payments from 3G and 4G networks accelerated. The non-payment of royalties from Apple have had a significant impact on Qualcomm’s earnings recently. We anticipate a growth rate of 4% per year until a resolution with Apple regarding licensing fees occurs.

While there is a dispute with Apple’s manufacturers, Qualcomm did receive a \$500 million payment from Huawei. The two companies are in negotiations to address licensing fees and the payment represents part of the royalties that is owed to Qualcomm. Qualcomm has made some concessions in hopes of ending its feud with Apple, including offering a lower-cost license on devices that use the company’s patented products. The company has offered to drop its 5% fee on the first \$500 of a device’s selling price to 3.25% fee on the first \$400 of a device’s selling price.

For the last 21 months, Qualcomm has tried to finalize its acquisition of NXP Semiconductors. After extending its cash tender offer for shares almost 30 times, Qualcomm finally agreed to terminate the acquisition. China was also withholding its approval, likely due to increased trade tensions between the country and the U.S. While NXP’s automotive products would have diversified Qualcomm’s business, the acquisition was weighing on the stock. In place of purchasing NXP, Qualcomm announced it would repurchase \$30 billion of its shares (~33% of the current market cap).

Qualcomm has increased its dividend for the past 16 years, with an average raise of more than 18% per year over the last 5 years. We expect dividends will increase at the same rate as dividends going forward.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	19.5	21	16.5	16.4	15.9	14.2	14.3	14.5	12.1	13.7	17.7	14.0
Avg. Yld.	1.4%	1.7%	1.8%	1.5%	1.6%	1.9%	2.0%	2.7%	3.8%	3.8%	3.9%	4.8%

Shares of Qualcomm have gained \$12, or 23%, since our May 4th update. While shareholders should approve of such a return in a short amount of time, the stock’s price to earnings multiple is now much higher than at the time of our previous update. While expected EPS for 2018 has increased slightly (\$3.61 from \$3.55), shares of Qualcomm trade with

a forward multiple of 17.7, well above the historical P/E of 14. If shares were to revert to this valuation, the stock would multiple contraction of 4.6% per year. If, however, a resolution on royalties can be made between Qualcomm and various other companies, we would likely assign a higher P/E.

Qualcomm’s current yield easily tops that of both the S&P 500 and the 10-year Treasury Bond. Investors looking for income could find Qualcomm’s dividend attractive and could be a “get paid as you wait for growth” type of scenario. Qualcomm has increased its dividend for the past 16 years. The most recently increased the dividend 9%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	31.5%	26.4%	25.1%	27.7%	28%	33.1%	32.5%	29.3%	26.4%	19.1%	20.8%	22.0%
Debt/A	26.9%	26%	31.8%	25.9%	22%	20.7%	19.4%	38.2%	39.3%	53%	48.5%	30.3%
Int. Cov.	---	---	---	---	---	---	---	---	---	---	---	---
Payout	26.7%	34.7%	29.3%	25.3%	25.1%	26.6%	29.2%	38.6%	45.5%	51.4%	67.3%	67.4%
Std. Dev.	41.7%	24.5%	34.3%	25.8%	23%	13.6%	12.4%	23.4%	23.5%	34.4%	32.7%	25.7%

Qualcomm suffered a severe decline in earnings during the last recession. While handheld devices have become more of a necessity amongst consumers, the company would likely see a decline in EPS due to their high costs. Qualcomm’s gross profits to asset ratio has declined steadily, but much of this is likely due to Apple’s lack of royalty payments. On the positive side, the company has around \$40 billion in cash and marketable securities on its balance sheet. Investment gains from these assets more than offset the company’s interest expense and give the company ample cushion to continue paying dividends even in the event of a protracted recession.

Qualcomm’s dividend growth has been impressive in recent years, but with earnings falling the payout ratio has started to climb. For much of the last 10 years, the payout ratio was ~30% of earnings. In order to see aggressive dividend growth, Qualcomm would need to show accelerated earnings growth.

Final Thoughts & Recommendation

After 3rd quarter earnings, we now anticipate that shares of Qualcomm can return 3.3% annually through 2023, down from 8.4% previously. This return is a combination of growth (4%), dividends (3.9%) and multiple contraction (4.6%). The stock has climbed aggressively since our last update, removing much of our annual return projections. The NXPI acquisition was weighing on the stock and now that has been removed. We maintain 2023 price target of \$60 and suggest shareholders wait for a pullback before purchasing Qualcomm’s stock.

Total Return Breakdown by Year

