

# Qualcomm gears up for showdown

## Analysis: ITC loss would have little impact right away

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Last update: 3:36 p.m. EDT Oct. 5, 2006

**WASHINGTON (MarketWatch) -- Shares of Qualcomm Inc. have fallen as much as 9% in the past few days ahead of a legal showdown next week with rival Broadcom Corp., but investors don't have reason to worry -- for now.**

Even if Qualcomm loses the bitterly contested patent dispute, the likely penalty probably would not take effect until next spring. Nor would an adverse decision pose a serious threat to sales and profits.

Perhaps a bigger danger is that a loss could embolden other rivals already engaged in battles with Qualcomm. A Broadcom victory could give them more ammunition to win related lawsuits involving claims of patent infringement or anticompetitive royalty fees. "It's widely known they're not widely liked in the industry," said longtime Qualcomm analyst Ed Snyder of Charter Equity Research. "If Qualcomm loses this suit, it could open the floodgates."

Given the almost leisurely flow of most court proceedings, however, Qualcomm is unlikely to get swamped by a series of legal defeats anytime soon. The company is very aggressive on the legal front and never gives an inch to competitors.

### **Pending patent ruling**

While Qualcomm and Broadcom are engaged in several lawsuits in federal courts, the most important case is taking place at an obscure federal agency called the International Trade Commission.

An administrative law judge at the ITC plans to rule Oct. 10 on whether Qualcomm violated several Broadcom patents on technology used in mobile phones. The technology allows the phones to surf the Web at fast speeds and download large files such as songs. Many investors expect the judge to rule against Qualcomm because a staff attorney issued a brief last spring indicating his view that the company did infringe on Broadcom patents.

Growing concern about Qualcomm's multiple legal disputes in general and the outcome of the ITC case in particular have triggered a 16% drop in Qualcomm's stock in 2006. The company's strong growth and rising profit has become a secondary focus.

Longtime patent attorneys, however, say Broadcom dispute is not an open-and-shut case. "There is no way for the public to predict the outcome because most of the information is not publicly disclosed," said Thomas Jarvis of Finnegan Henderson, who has handled dozens of ITC cases over 20 years. "The intense interest and predictions are speculative."

Broadcom chose to file suit at the ITC because the agency acts faster and with more authority to ban imports of products found to have violated the patents of other companies. The ITC moves more swiftly than federal courts.

Even if Broadcom wins, the ITC would not move immediately to ban Qualcomm from importing chips used in "next-generation" wireless phones. The chips, manufactured for Qualcomm by foreign suppliers, are used in handsets such as the ones Verizon sells to business customers who use its high-speed mobile service.

The judge could order several remedies, for starters. And whatever he decides would be reviewed by a six-member panel at the ITC composed of three Democrats and three Republicans. The panel can take up to four months -- with a target date of early February -- to accept, reject or revise the judge's recommended penalty.

After the panel acts, the U.S. president would then have up to 60 days to accept or reject an import ban. As a result, any ITC ban might not take effect until early April. "We are fairly early in the in the ITC process," analyst Daryl Armstrong of CitiGroup told clients. "To compare the ITC process to a baseball game, we are still in the third or fourth inning with much more action potentially ahead of us."

### **Not a big business yet**

In the short run, financial analysts say, a ban on Qualcomm chips would have a limited impact on the company's financial health. The market for next-generation wireless phones in the U.S. is still quite small, although Qualcomm executives believe it holds great promise.

Citigroup estimates Qualcomm would lose, at most, the opportunity for about \$100 million in sales in 2007 if the ITC slapped a ban on the chips in question. It would also cost the company no more than a penny a share in potential earnings next year.

Yet analysts point out that Qualcomm derives most of its money from royalties on its wireless transmission standard known as code division multiple access. CDMA is used by Verizon, Sprint Nextel Corp. and several large Asian carriers to transmit mobile calls. The technology is also used in chips that run the phones used by those carriers.

"There's financial risks and there's headline risks," said Snyder, calling the likely impact of an ITC loss a nonfactor.

A bigger concern is that an unfavorable ITC ruling could help rivals such as Nokia in their own legal tangles with Qualcomm in the U.S. and Europe. Qualcomm cross licenses technology with Nokia, but their agreements run out next spring.

Unless Qualcomm renews the cross-licensing agreement, many analysts believe the company could be forced to spin off its chip business. Chief Executive Paul Jacobs has said Qualcomm considered that option before and would consider it again.

The more important issue is whether Qualcomm can maintain its high royalty fees, which Nokia and others claim are excessive.

The legal battles over royalty fees, however, are likely to drag on a lot longer than the dispute over the chip business. Investors who plan to stick around better get used to the uncertainty. It's here to stay. ■

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