

NEW RISK ALERT: (AVGO)

Broadcom Hints at Potential Gross Margin Pressure in Latest 10-K

Changes offer potential clues about AVGO's relationship with Apple, increased Huawei risk, and possible reduced production yields

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This alert compares the language used in the company's latest filing with the period before. [Research](#) suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Apple's Leverage May Squeeze Broadcom's Margins

The majority of AVGO's revenue comes from a small number of customers. Apple accounts for 15% of Broadcom's sales, its top five customers account for thirty-percent. Last year, AVGO warned in its 10-K that its customer concentration could impact sales and profitability:

*"...we may not generate the amount of revenue or the **level of profitability** we expect ...If we do not perform under these arrangements, we could also be liable for significant monetary damages."*

In the 2020 10-K, Broadcom added new language suggesting an increased risk that large customers may request additional pricing concessions:

*"Moreover, our top customers' purchasing power has, in some cases, given them the ability to make greater demands on us with regard to pricing and contractual terms in general. We expect this trend to continue, which may **adversely affect our gross margin** on certain products and, should we fail to perform under these arrangements, we could also be liable for significant monetary damages."*

Wafer Delay Risk Rises

Broadcom relies on TSMC for 87% of the wafers manufactured by contract manufacturers. TSMC also manufactured wafers for AVGO's competitors, which Broadcom warned last year that:

“...and could choose to prioritize capacity for other customers or reduce or eliminate deliveries to us on short notice, or raise their prices to us, all of which could harm our business...”

In its 2020 10-K, Broadcom suggests the risk has crystalized due to restrictions impose on Huawei:

*“For example, Huawei Technologies Co. Ltd. (“Huawei”), as well as many of its suppliers, have significantly increased their wafer orders from TSMC due to certain U.S. export restrictions on sales to Huawei. **This has caused, and may continue to cause, some dislocations in the semiconductor supply chain which may result in reduced or untimely wafer deliveries to us.**”*

Rising Risk of Supply Constraints Specified

Last year, Broadcom warned that it purchases from a limited number of suppliers:

“Suppliers may extend lead times, limit supplies or increase prices due to commodity price increases, capacity constraints or other factors, which may lead to interruption of supply or increased demand in the industry.”

In its 2020 10-K, Broadcom adds language that specifies which components are constrained:

*“For example, due to the COVID-19 pandemic, we have experienced some supply constraints, including with respect to **wafers and substrates.**”*

Likewise, last year AVGO warned of its ability to secure enough supply to ramp quickly to meet demand:

“We may be unable to secure sufficient materials or contract manufacturing capacity to meet such increases in demand.”

In its 2020 10-K, Broadcom added language which broadened the scope of the risk:

*“We may be unable to secure sufficient materials or contract manufacturing **or test capacity** to meet such increases in demand.”*

Note this warning contradicts a COVID-19 related statement included in the MD&A section:

*“However, the disruptions in our outsourced assembly and **test capacity** that we experienced previously, as a result of COVID-19 related shutdowns, have now **largely resolved.**”*

Reduced Production Yields May be Headwind

In its latest annual report, Broadcom adds language when outlining the risk of not being able to meet capacity to include possible design issues that result in reduced yield:

*“Similarly, **reduced product yields, due to design or manufacturing issues or otherwise**, may involve significant time and cost to remedy and cause delays in our ability to supply product to our customers, all of which could cause us to forgo sales, incur liabilities or lose customers, and harm our results of operations.”*