

Rev/Employee: \$1.22 M

Number of Employees: 21,000

Avg ROIC: 11.42%

Other IT Software

## AVGO: Succession for a Sustainable Franchise

Broadcom's President & CEO Hock Tan (73) has built an impressive company over his nearly 2 decades at the helm. The CEO has always emphasized a focus on "sustainable franchise" business' where the roadmap can profitably extend out at least a decade. Tan has astutely used acquisitions to quickly grow share, including last year's \$80+ billion VMware acquisition ([see our prior report here](#)), and then rigorously cut costs to deliver truly accretive deals. Key man risk has been a material issue at AVGO for a long time and we think it has reached a dangerous point however. CEO Tan's age and a 2023 stock grant suggest his retirement is looming but many of the other key drivers in the senior management team are also at logical retirement ages. The management team's Insider selling of their deeply in-the-money equity stakes suggests estate planning and taking personal skin-in-the-game risk out of the Company's future performance.



**Management Update:** Hock Tan has been the CEO since 2006 and dominates the firm's interactions with the financial community and investors. The CEO has perfected a serial roll-up model that allows AVGO to acquire large firms and quickly squeeze out operating expenses to make the deals hugely accretive. Despite his advancing years, he continues to radiate an impressive vision and confidence in the firm and industry's future. See an [interesting VMware presentation by the CEO here](#). Tan is also a Director of Meta Platforms. We note that AVGO has significant customer concentration and international risk from tariffs with 71% of FY'24 sales (and over half the employees) coming from outside of the Americas. The Company is run as two operating divisions, Semiconductor (55% of TTM revenue and ~56% EBIT margin) and Infrastructure Software (~45% of TTM revenue and ~74% EBIT margin). CFO Kirsten Spears (60) also holds the title of Chief Accounting Officer, which we think should be a separate person given the scope of the job. Spears joined AVGO in 2014 when it acquired LSI Logic where she was their Controller. After the acquisition, she became AVGO's Controller until she was promoted to CFO at the end of 2020. Spears has kept a rigorous cost efficiency in place during her tenure. The CFO reported that Fiscal 2024 revenue hit a record \$51.6 billion, up 44% Y/Y including VMware, and 9% organically (excluding VMware). Semiconductor revenue was \$30.1 billion, up 7% Y/Y. Infrastructure software revenue was \$21.5 billion, up 181% Y/Y and up 90% year-on-year excluding VMware. At VMware operating costs have dropped to under \$1.2 billion a quarter which is roughly half the quarterly spend rate prior to AVGO's acquisition and are now part of a blended 70% operating margin in Infrastructure software. We particularly like that CFO Spears used the strong cash results last year to cancel \$5.2 billion in AVGO shares held in treasury to cover employee tax withholding of net-settled equity awards in fiscal 2024. Among the logical inside candidates to become the future CEO, we think Charlie Kawwas, PhD (54) is the most likely. Kawwas is the divisional President of the Semiconductor Solutions Group (\$8.2 billion in Q1'25 revenue, up 11% Y/Y). The unit generated about 58% of FY'24 total revenue, which was down as a percentage from 79% in '23 due to the addition of VMware but benefited hugely from so-called "AI Accelerators" or XPU chips. Last fall, speaking at an investment conference, he said "we have the custom XPU and we have the rest of the merchant networking portfolio. Custom XPUs, it's really driven by the three customers and we talked about them last week in the earnings call. They are all in production and continue to grow and that's about two-thirds of the business. The remaining one-third is the networking merchant silicon that we have, and that actually for AI, we provide that solution to everybody. So, anybody in the hyperscale space or anybody that is actually building systems that go into enterprise, so we can cover the entire market for that and that's about a third of that business." Prior to his current role (promoted in '22), Kawwas served as the group COO for 18 months. He has been working at AVGO since the company acquired LSI in 2014 where he spent 9 years (2005-14) and was their head of Worldwide Sales and subsequently became Chief Sales Officer at AVGO. Prior to LSI, he worked at Nortel Networks for 12 years. Kawwas holds a PhD in Electrical and Computer Engineering from Canada's Concordia University.

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**Pay & Incentive Alignment:** Management's pay plan at AVGO is well aligned with investors but also signals the key man risk associated with the CEO. Management's total cash pay each year is modest but they receive substantial equity grants. CEO Tan's nominal total pay in 2024 totaled only \$2.6 million with a \$1.2 million salary and \$1.4 million in "Other" pay (primarily for residential and personal security).

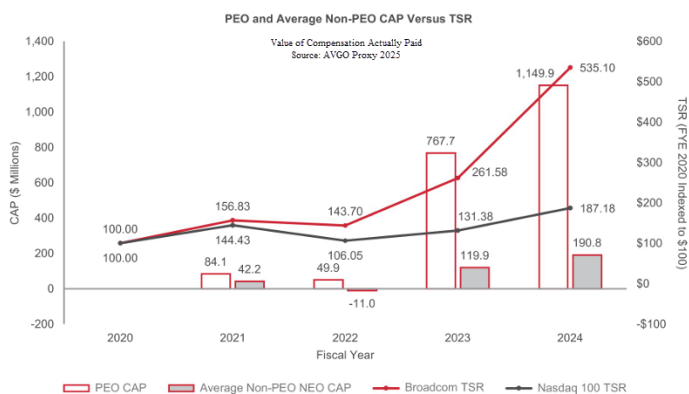
However, investors will note that Tan received a huge \$161.8 million equity grant in 2023, which included a \$159 million worth of performance vesting PSUs that will vest on relative total return vs the S&P 500 over the next

4 years. As part of his large FY'23 PSU grant, CEO Tan will forego cash bonuses and equity grants for the next 5 years. If he retires for good reason prior to the full 4 year term of his PSU grant he will receive a pro-rated (through date of resignation) vesting of any earned shares which is currently worth over \$800 million. CFO Spears is paid a modest \$421k salary and received a \$621k cash bonus for total pay worth \$1.1 million. Similarly, she received a large \$14.3 million equity grant the prior year (40% of which was in time-vesting RSUs and 60% in performance vesting PSUs). EVP Charlie Kawwas' salary is \$736k and he received a \$1.1 million cash bonus for total pay worth about \$1.9 million. In 2023, he also received a \$48.2 million PSU grant that covered the next 5 years.

Annual cash bonuses are determined by 2 good equal weighted operating factors of revenue growth and operating margin targets and targeted at 1x salary. There's also an individual performance modifier that can raise or lower bonuses by up to 50%. Last year, the modifier boosted bonuses by 20% and the executives received cash bonuses at 137% to 153% of their targets. CEO Tan typically receives his entire long term equity LTIP in performance vesting PSUs and it's split 60/40% PSUs and RSUs for the other executives. RSUs vest 25% per year. The PSUs vest based on relative total return over 4 years versus the S&P 500 and no shares vest for bottom quartile performance. We like that no dividend equivalents are paid on unvested RSUs or PSUs and that the Board has not granted stock options since 2015.

**Equity Ownership:** We like that the CEO is required to hold at least 6x his salary in stock, although in Hock Tan's case he dwarfs the requirement with a beneficial stake of about 1.9 million shares. Other EVPs are required to hold at least 3x their salaries in shares. Co-founder and Chairman Henry Samueli, PhD is the firm's largest personal stakeholder with a vested stake of just under 88 million shares (mostly held through family office H&S Ventures) or roughly 2%. We note that the Board has given Chairman Samueli permission to use about \$2.7 billion of his personal equity holdings to secure a personal loan for a development project called OCVIBE in Orange County, California. Fellow Director, and Silver Lake partner, Ken Hao beneficially owns about 1.6 million shares. EVP Kawwas beneficially owns about 765k shares and CFO Spears beneficially owns about 253k shares. AVGO did a 10:1 stock split in July last year. We note the substantial Insider selling at AVGO since January 1, 2024 with CEO Tan netting proceeds of about \$195 million, CFO Spears over \$42 million, EVP Kawwas \$43 million, and General Counsel Brazeal \$46 million during that time period. Among major institutional, active share, investors, Capital Research owns over 400 million shares or about 9.9%, Fidelity Management owns 1.6%, and Norges Bank about 1.5%.

**Capital Allocation Update:** AVGO remains highly levered and has been somewhat slower than expected in paying down its debt from the VMware acquisition. CFO Spears has repaid some of the debt and refinanced maturities used to finance the November 2023 VMware acquisition. The CFO paid down about \$1.1 billion last quarter and ended fiscal Q1 '25 with \$66.6 billion in debt (49% debt/total capital, compared to \$67.6 billion (50%) at the end of FY '24). Roughly \$58.8 billion of that is fixed rate notes with a weighted average coupon of 3.8% and a 7.3 year maturity. Vanguard, PIMCO, and Fidelity are the largest bond holders. AVGO ended Q1 with \$9.3 billion in cash but we note that management has been slower to pay down its acquisition related debt balance than it





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has been on many of its past acquisitions and considering the strong FCF in the last year. Management financed the VMware acquisition with \$30.8 billion in cash and 544 million AVGO shares worth \$53.4 billion. They subsequently sold the end-user computing business for about \$3.5 billion. Last year, management also spent \$600 million to purchase certain Seagate Technology assets for the design, development, and manufacture of System-on-Chip operations. CFO Spears has plenty of free cash flow with which to work. Fiscal year 2024's FCF was \$19.4 billion.

Q1'25 operating cash flow was \$6.1 billion, and the CFO spent only \$100 million on CapEx and \$1.4 billion in R&D in Q1. AVGO spent a total of \$17 billion last year (\$9.8 billion in dividends and \$7.2 billion on stock buybacks). Notably in Q1 '25, the CFO did not do any repurchases, but quarterly dividend outlays were \$2.4 billion. AVGO's Board has a history of consistent annual dividend increases, including over 11% last year to \$0.59 (~1.2% split adjusted).

**Fiduciary & Other:** Co-founder and former CTO Henry Samueli, PhD (70) serves as Chairman of the aging 9 person Board and we note that the Board considers him independent despite his prior role as CTO. He co-founded Broadcom in 1991 and has been on the Board since 2016. Kenneth Hao (56) is a major shareholder and the newest addition to the Board and joined last year. Hao is the Chairman and Managing Partner of private equity firm Silver Lake. Eddy Hartenstein (74) is the Lead Independent Director, but we note he's been on the Board since '16 and required to offer his resignation when he turns 75. Board rules say that when a non-employee Director reaches the age of 75 years, they are required to offer their resignation. Hartenstein also Chairs the Nominating Committee that coordinates with the Chairman in matters of CEO succession planning. Other long-serving Directors include Gayla Delly (65, Director since 2017), Director Low (Director since 2016), Director Delly Chairs the Audit Committee. She is a CPA and former President and CFO at Benchmark Electronics. Delly is also a director of Flowserve Corporation and Littelfuse. AVGO's Auditor firm is PricewaterhouseCoopers which received \$42 million in fees last year.