Intel (INTC)

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Disclaimers

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• No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments
## Intel - business

<table>
<thead>
<tr>
<th>Net revenue (In Millions)</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PC Client Group</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Microprocessor revenue</td>
<td>$6,823</td>
<td>$5,692</td>
</tr>
<tr>
<td>Chipsets, motherboards, and other revenue</td>
<td>1,798</td>
<td>1,683</td>
</tr>
<tr>
<td><strong>Total net revenue</strong></td>
<td>$8,621</td>
<td>7,375</td>
</tr>
<tr>
<td><strong>Data Center Group</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Microprocessor revenue</td>
<td>2,061</td>
<td>1,552</td>
</tr>
<tr>
<td>Chipsets, motherboards, and other revenue</td>
<td>403</td>
<td>319</td>
</tr>
<tr>
<td>Other Intel architecture operating segments</td>
<td>2,464</td>
<td>1,871</td>
</tr>
<tr>
<td>Other Intel architecture operating segments</td>
<td>1,149</td>
<td>674</td>
</tr>
<tr>
<td>Software and services operating segments</td>
<td>240</td>
<td>58</td>
</tr>
<tr>
<td>All other</td>
<td>373</td>
<td>321</td>
</tr>
<tr>
<td><strong>Total net revenue</strong></td>
<td>$12,847</td>
<td>$10,299</td>
</tr>
</tbody>
</table>
## Intel - business

- Operating income (loss)  2011  2010
- PC Client Group$  3,543  3,087
- Data Center Group  1,222  833
- Other Intel architecture operating segments
- (36 )  26
- Software and services operating segments
- (52 )  (44 )
- All other  (519 )  (454 )
- Total operating income  4,158  3,448
Intel - business (cont’d)

• Competition:
  • ARM and related
  • AMD
  • nVidia
Intel - Misc thoughts

• What can go wrong?
  • Non-Intel mobile device growth leading to non-Intel computer growth and marginalization of Intel CPUs
  • Not enough Intel CPU growth leading to diworsefication trying to build out other product areas: McAffee acquisition

• Opportunities:
  • Continued Intel-based enterprise and cloud solutions
  • Recapturing mobile space
Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? WinTel, Apple Mac, Enterprise platforms
  - What does it take to sustain the moats? Sustaining Intel PC universe and either capturing or at least isolating mobile device universe
  - Bargaining power of suppliers/customers? Not big. Intel has much more power as supplier
- Is it a low risk business? Somewhat.
- Is there high uncertainty? Not very
- How capital intensive is the business? Fabs and development are somewhat capital intensive
- Future growth - depends on mobile space capture and PC/enterprise growth/decline
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Possibly overstated for last year
Management

- I don’t usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
Piotroski Score

Only applicable to Graham Cos - N/A to INTC

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

- Total: / 9
Is it a good business?

- >10 year history of profits
- ROE:
  - 2009: 10 2010:23 2011 q1: 26
- Margins
  - 2009: 12 2010:26 2011 q1: 24
- Growing earnings: 3 year sales growth 11%, earnings growth 34%
- No dilution
- Strong balance sheet
  - Debt << cash/short term investments
- ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)
  - ~= ROE
Is it a good business? Cash flow

- Strong operating cash flow, but not FCF (acquisitions)
  - 2011 Q1 3B earnings, 4B operating cash flow, negative FCF (FCF = OCF - capital expenditures)
  - Free Cash Flow/Share not higher than dividends paid
Is business cheap? - Buffettology calculations

- ROE 15%
- Earnings in 10 years = ROE*Equity*(1+ROE)^9 = $25B
- Equity in 10 years = Equity*(1+ROE)^9 = $166B
- Market cap = 25B x P/E (15) = $375B
- Rate of return = 10% after tax (calculations omitted)

- 9 year earnings growth: N/A (tech boom/crash 2000-2001)
  Assuming 10% earnings growth: 13% share price growth.
Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 12.6B
  - 10% growth for 5 years, leveling after that
    - 15% discount -> $122.5B current valuation (if you buy company at <$122.5B, you will get 15% return or higher)
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $113B current valuation

- Owner’s yield = earnings / (market cap + debt - cash) = earnings/EV
  - 12.6B / (123B-5B) = 10.7%

- What makes up the margin of safety? WinTel+Apple Mac monopoly, strong market position, strong current earnings yield, strong balance sheet
- Is there a sufficient margin of safety? Yes
Is business cheap? - Graham investment considerations

• N/A for INTC - included for completeness
• 2.6 P/Book - not a net net
• Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)