Intel (INTC)

Raimondas Lencevicius

Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Intel - business

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

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)