

January 13, 2016

INTC 4Q – 2015 Earnings Preview

4Q FY-2015 Earnings: Guidance, Analyst vs. Year Ago 4Q Revenue

	Guidance	Analyst	4Q-2014
Revenue	14.3 – 15.3 b	14.6 – 15.0 b	14.72 b
Non-GAAP EPS	0.58 - 0.68	0.60 - 0.68	0.74

Revenue in dollars, b is billion; non-GAAP EPS in dollars per share. Analyst is the consensus analyst estimates from Yahoo Finance.

Full Year 2015: Guidance vs. Analysts vs. 2014 Actual

	Guidance	Analyst	Full Year 2014
Revenue	54.74 – 55.74 b	55.04 – 55.44 b	14.72 b
Non-GAAP EPS	2.17 – 2.27	2.12 – 2.32	2.31

1Q-2016 Analyst Estimates vs. 1Q-2015 Actual

	Analyst Est's	1Q-2015
Revenue	13,2 – 14.5 b	12.78 b
Non-GAAP EPS	0.44 – 0.57	0.41

Review by Business Segment

	3Q-2015	2Q-2015	4Q-2014
Client Computing Group	8.5 b	7.4 b	8.9 b
Data Center Group	4.1 b	3.7 b	4.1 b
IoT Group	0.581 b	0.53 b	0.591 b
Software & Services	0.556 b	0.53 b	0.557 b
All Other	0.682 b	0.62 b	0.617 b

In 1Q-15, **INTC** merged its Mobile segment into its old PC Group segment to create a new segment called the Client Computing Group (CCG). In 4Q-2014, PC Group revenue was \$8.9 billion and Mobile revenue was a negative \$1 million. The negative Mobile revenue reflected the robust contra-revenue program in place to subsidize the distribution of certain processors like Atom into tablets and other mobile devices.

The new 3D NAND non-volatile memory products are included in the "All Other" segment.

Software and Services includes McAfee and other endpoint security products.

The PC Business

Slowing desktop sales in small and medium businesses had the most impact upon the PC business. Desktop platform volumes declined 22% from 2Q-14 and were flat with 1Q-15. Tablet volumes increased 11% over 2Q-14.

For the full year 2015, **INTC** now estimates that the PC market will decline in the high-single digit range, i.e., 8%. This means that CCG revenue will likely decline to about \$31 billion versus \$34.9 billion in 2014.

Data Center Group

In the first six months of 2015, DCG operating profit increased 11% over the same period in 2014. For the year, I expect DCG revenues to increase at least 13% over 2014. Management reduced expectations slightly at the last conference call.

Full Year 2015 Outlook

The company also expects “robust growth” in its other revenue segments. It expects this growth plus the Data Center Group’s revenue growth to offset the decline in PC revenue.

Quarterly Results and RIR Estimates (2Q-2014 to 4Q-2015)

	<u>2Q-14</u>	<u>3Q-14</u>	<u>4Q-14</u>	<u>1Q-15</u>	<u>2Q-15</u>	<u>3Q-15</u>	<u>4Q-15E</u>
Revenue	13.831	14.554	14.721	12.781	13.195	14.465	14.800
Cost of Sales	4.914	5.096	5.29956	5.051	4.947	5.354	5.624
Gross Profit	8.917	9.458	9.42144	7.73	8.248	9.111	9.176
R&D + MG&A	4.920	4.821	4.900	4.948	5.036	4.837	5.000
Restructuring	0.081	0.020	0.045	0.105	0.248	0.014	0.025
Amortization	0.072	0.077	0.065	0.062	0.068	0.068	0.07
Total Op-Ex	5.073	4.918	5.010	5.115	5.352	4.919	5.095
Operating Income	3.844	4.54	4.41144	2.615	2.896	4.192	4.081
Investment Gains	0.095	0.035	0.095	0.058	0.100	0.165	0
Interest et al	-0.017	-0.025	0.08	0.026	-0.013	-0.104	0
Pre-Tax Income	3.922	4.55	4.58644	2.699	2.983	4.253	4.081
Income Tax	1.126	1.233	1.24	0.681	0.277	1.144	1.020
Net Income	2.796	3.317	3.34644	2.018	2.706	3.109	3.061
Basic Shares	4.981	4.88	4.88	4.741	4.759	4.747	4.747
Diluted Shares	5.123	5.045	5.045	4.88	4.909	4.876	4.876
Basic EPS	0.56	0.68	0.69	0.43	0.57	0.65	0.64
Diluted EPS	0.55	0.66	0.66	0.41	0.55	0.64	0.63

Lower gross and net margins together with relatively flat second half revenues will cause full year 2015 to be close to flat on the top line with 2014, but net income and EPS will decline over 10% from 2014. Furthermore, the acquisition of **Altera (ALTR)** prevented **INTC** from buying back shares as aggressively as it did in 2014. Instead, **INTC** is conserving its cash until it can sell its debt offering of \$8-9 billion to fund its all-cash offer to buy **ALTR**. This deal closed December 28, 2015.

Full Year 2015 (RIR's Estimate) vs. 2014 Actual

	<u>FY-14</u>	<u>FY-15E</u>
Revenue	55.870	55.241
Cost of Sales	<u>20.281</u>	<u>20.976</u>
Gross Profit	35.589	34.265
R&D + MG&A	19.7	19.821
Restructuring	0.295	0.392
Amortization	<u>0.294</u>	<u>0.268</u>
Total Op-Ex	20.289	20.481
Operating Income	<u>15.300</u>	<u>13.784</u>
Investment Gains	0.32	0.323
Interest et al	<u>0.134</u>	<u>-0.091</u>
Pre-Tax Income	15.754	14.016
Income Tax	<u>4.096</u>	<u>3.122</u>
Net Income	<u>11.658</u>	<u>10.894</u>
Basic Shares	4.8	4.75
Diluted Shares	4.914	4.88
Basic EPS	<u>2.43</u>	<u>2.29</u>
Diluted EPS	<u>2.37</u>	<u>2.23</u>

These forecasted declines in revenue and earnings have caused the stock market to reduce the multiple from 17.5x to 15x estimated 2015 earnings. This is reflected in its share price remaining in the low \$30 range.

All Other Segment Gains Traction

In addition to the Data Center Group (DCG), **INTC's** "All Other" category is beginning to grow both on the top line and the bottom line. A large component of this group is the non-volatile memory group that is bringing the new 3D memory to market in partnership with **Micron (MU)**.

INTC has incurred many usual start-up costs with this product. This has helped push the segment's net income negative for the past year. However, as the

products now begin to sample, the losses from this group have begun to decline. Also, revenue in this segment increased 38% in 2Q-15 over 2Q-14. There exists a \$1.2 billion gain in net income that can be realized from this segment alone in 2016 if things ramp on schedule. By itself, that would almost offset the decline in net income experienced this year by **INTC** from weakness in its CCG.

Conclusion

I am playing a long game here. **INTC** infers that its annual DCG revenue will approach \$25 billion by 2018. It also suggests strong growth in the "All Other" category which contains the 3D NAND memory unit. Finally, the PC cycle will again turn positive between now and 2018. These three factors will lead to a surge in revenue and profit that should boost **INTC's** share price above \$50 for a greater than 50% gain between now and then.

INTC is a core holding at RIR because its products are central to the newly emerging cloud computing services. It will also gain traction with its new memory product. Its **ALTR** acquisition opens up the innovative possibilities of a combined CPU and FPGA in 3-5 years. In the meantime, the stock yields 3.3%.

In my 2Q-2015 review, I concluded:

*Short term, I think that **INTC** shares will move back to \$34-37 in 6-9 months.*

The stock rebounded to \$35.59 on December 29, before pulling back to the low \$30's in the current sell-off. In 2016, I expect **INTC** to move to a \$38-42 range, another 30% of appreciation plus its new dividend of \$1.04 per year.

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As of the date of this publication, I am long **INTC**.

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