

## Focus Stock Report

November 24, 2009

### Intel Corp. (INTC U\$19.39, Outperform, Target U\$27.00)

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#### Company Description

Intel Corp. (INTC) designs, manufactures, and sells computer components and related products. Intel is best known for its integrated circuits or microprocessors that go into desktop and notebook computers. Investors will recognize the Pentium and Celeron labels. Intel is the top player in the semiconductor industry with about 80% market share for processors.

A microprocessor, also known as the central processing unit is the brains of a computer. It processes system data and controls other devices. Intel's top microprocessors have multiple cores enabling improved multi-tasking and energy efficient performance. Microprocessor sales follow a seasonal pattern where sales are stronger in the second half of the calendar year than the first half.

The company also designs and manufactures embedded processors for industrial applications and networking equipment markets; chipsets, motherboards, flash memory products, graphic components, communications products, and digital imaging products.

Hewlett Packard (HPQ) and Dell (DELL) are Intel's largest customers accounting for approximately 20% and 18% of sales in 2008, respectively. No other customer accounts for more than 10% of the company's revenue. Advanced Micro Devices (AMD) is Intel's most formidable competitor.

Intel has structured its business under two primary operating segments: Digital Enterprise Group and the Mobility Group (revenue break down along these lines can be found in the chart to the right). The mobile communications segment is viewed as a key source of growth for Intel and comprised almost 42% of total revenue in 2008 compared with 35% only three years ago.

In 2008, 70% of Intel's wafer fabrication was conducted in the United States. The remaining 30% was conducted in facilities in Ireland and Israel. The Company is building a new wafer fabrication facility in China which should go into production sometime in 2010. To augment capacity, Intel also uses third-party manufactures.

Intel Corp.  
(INTC-Nasdaq)

Rating: Outperform

Risk: Low

#### Summary Data (U\$)

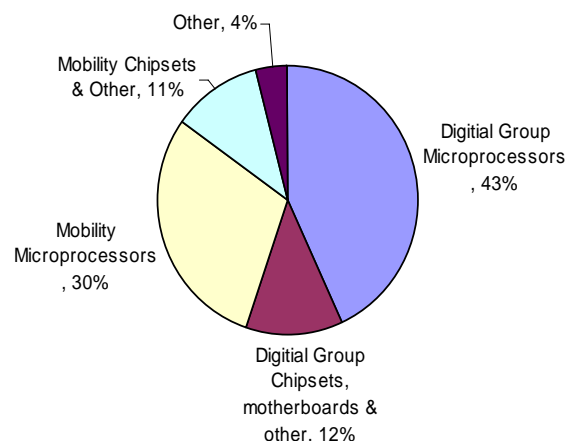
<b>Price (Nov. 24/2009):</b>	\$19.39	<b>Fiscal Year-End:</b>	December
<b>12-Month Target:</b>	\$27.00	<b>Dividend:</b>	\$0.63
<b>Total Return:</b>	42%	<b>Yield:</b>	3.2%
<b>52-Week High:</b>	\$21.27	<b>52-Week Low:</b>	\$12.05
<b>ROE Trailing 12 Months</b>	12.2%	<b>Market Value (\$mil)</b>	\$107,072

#### Earnings Per Share (U\$)

Annual	2007A	2008A	2009E	2010E
<b>EPS:</b>	\$1.22	\$0.98	\$0.92	\$1.60
<b>P/E Multiple:</b>	21.8x	15.0x	21.1x	12.1x

Source: Credit Suisse, Bloomberg

2008 Revenue Breakdown by Product



Source: Bloomberg

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While much of the Company's productive capacity resides in the U.S., Intel is very much a global company with 85% of sales coming from international markets and more than half from the Asia Pacific region.

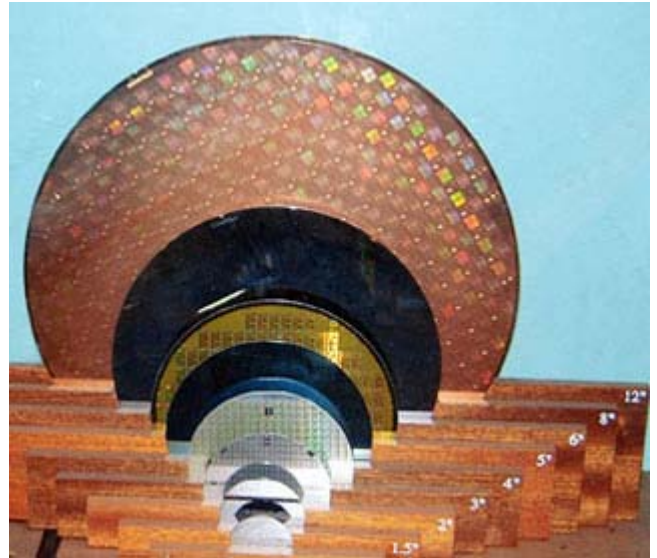
Intel is highly dependent on the success of its microprocessor business. One of the key challenges in developing computing and communications components is balancing high-end performance with power consumption. Intel's R&D effort is massive and has allowed it to stay on the cutting edge of technology advances. R&D expenditures in 2008 were US\$5.7 billion, comparable to Advanced Micro Devices revenues that year.

*Source: Intel Corp.*

### The Importance of Wafer Size and Process Technology

A wafer is a thin circular slice of silicon crystal used in the fabrication of integrated circuits and other micro devices. Molten silicon is pulled into cylindrical ingots which are sliced into wafers (see picture to the right). The larger the wafer the lower the marginal space around the perimeter and therefore the greater the yield or number of processors that can be produced from each wafer. When Intel first began making chips the Company printed circuits on two inch wafers. Intel currently uses 2 wafer sizes – 200 mm (8") and 300 mm (12"). A current state of the art fabrication facility produces 300 mm wafers. Intel, along with other competitors, is currently working on 450 mm prototypes. However, the productivity enhancements come at the significant cost of retooling or building new factories, that latter at a cost of \$3-\$4 billion.

Process technology refers to the size of the transistors on a chip. A transistor acts as a switch controlling the flow of electrical current in the device. The industry benchmark for transistor density is 45nm (nanometre). Intel has moved to the next level launching production of 32nm processors in September. To provide perspective, Intel's 386 had 275,000 transistors whereas Intel's Core QX9650 has around 800 million – nearly 3,000 times as many! A smaller transistor consume less power and by drawing lower power reduces heat so they can run at higher frequency without burning out. Another benefit is higher yield per wafer.



### Key elements supporting this investment include

**Play on Economic Recovery:** As the economic recovery gains momentum there should be an uptick in capital spending, particularly in the area of enterprise spending on technology which is expected to drive growth in server demand. Credit Suisse anticipates that the investment community is underestimating the strength of the corporate PC replacement cycle in 2010 which will ultimately further contribute to Intel's market leading position.

A recent study of the semiconductor equipment sector by Credit Suisse concludes that inventory restocking will drive a 25% increase in industry sales in 2010, above current street expectations for a 14% increase in sales. Increased enterprise spending, which represents approximately 65% of revenues, should be driven by pent up demand resulting from an aging corporate desktop that averages about 5 years.

**Emerging Markets Opportunity:** Intel is well positioned to take advantage of the secular shift occurring in the computer industry whereby the introduction of lower price-point PCs and "netbook" computers will dramatically increase global PC penetration among consumers, much like the growth witnessed for cell phones earlier this decade; much of that sales growth is expected to surface in emerging markets.

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**Competitive Strengths:** Intel has a number of competitive strengths including:

- Market leadership/share
- Technology leadership
- Scale provides operating leverage
- R&D budget dwarfs competitors
- Strong brand recognition
- Product reputation and reliability
- Strategic partnerships with OEMs

**Persistent Profitability:** Intel has made money in each of the last 15 years and despite the severe recession of the last year, is expected to earn more than US\$5 billion in 2009. Intel's largest competitor AMD has consistently lost money over the last several years and is not forecast to earn a profit through 2012.

**Earnings Rebound:** After declining in 2009, earnings are forecast to rebound sharply in 2010. Credit Suisse is forecasting earnings growth of 74% in 2010 driven by a continued recovery in the global semiconductor market. Management has become increasingly confident about the company's prospects, further raising revenue guidance following the release of Q3 financial results, which for the third time this year beat expectations. Margins strengthened in the quarter and the transition to a 32nm manufacturing process will propel margins higher in future quarters. New products supported by next generation processor architecture should lead to market share gains for Intel in the computer marketplace. An improvement in server growth would also assist gross margin improvement. Intel continues to pursue an acquisition strategy that will lead to greater product diversification and growth opportunities. A recent strategic alliance with Nokia opens a new market for the company as they pursue opportunities to provide technology solutions to the mobile communications industry.

**Balance Sheet:** Intel has a pristine balance sheet with a net cash position of US\$10.7 billion (US\$1.94 per share) at the end of the third quarter even after buying back US\$1.7 billion of its shares.

**Valuation:** although INTC shares have rallied almost 60% since the market bottomed in March, 2009, the performance has lagged the broader S&P500 Index and the Information Technology sub-sector. Current valuation represents a buying opportunity as earnings forecasts have increased substantially during the intervening period and the stock trades at an attractive P/E multiple of 13 times forward earnings based on consensus estimates, (12 times using Credit Suisse estimates), compared to its average over the past three years of 19 times, or the 10-year average of 28 times.

Income Statement (US\$ millions)				
	2010 E	2009 E	2008 A	2007 A
Total Sales	38,800	34,658	37,586	38,334
Cost of goods sold	<u>15,422</u>	<u>15,675</u>	<u>16,742</u>	<u>18,317</u>
Gross margin	23,378	18,983	20,844	20,017
R&D	5,800	5,500	5,722	5,760
Marketing, general, admin. exp.	5,480	5,220	5,458	5,406
Other operating expense	<u>0</u>	<u>1,550</u>	<u>251</u>	<u>16</u>
Total operating expense	11,280	12,270	11,431	11,182
Operating Income	12,098	6,713	9,413	8,835
Gains on equity securities (net)	-150	-311	-1,756	157
Interest and other income (net)	245	208	488	793
Pretax Income	12,193	6,610	8,145	9,785
Income taxes	3,170	1,434	2,504	2,550
Net Income	9,023	5,176	5,642	7,235
Gross profit margin	60.3%	54.8%	55.5%	52.2%
Operating margin	31.2%	19.4%	25.0%	23.0%
Net margin	23.3%	14.9%	15.0%	18.9%

Source: Credit Suisse

Industry Comparables								
Company	Ticker	Price	EPS		P/E		EPS Growth	EV/EBITA
		Nov. 24, 2009	2009	2010	2009	2010	09-10	Trailing
Intel Corp.	INTC	\$19.39	\$0.93	\$1.48	20.8	13.1	59%	9.3
Advanced Micro Devices Inc.	AMD	\$6.95	-\$1.40	-\$0.62	n.m.	n.m.	n.m.	n.m.
Texas Instruments Inc.	TXN	\$25.28	\$1.16	\$1.77	21.8	14.3	53%	10.8
Broadcom Corp.	BRCM	\$29.30	\$1.11	\$1.55	26.4	18.9	40%	n.m.
Analog Devices Inc.	ADI	\$29.74	\$1.46	\$0.82	20.4	36.3	-44%	12.7
National Semiconductor Corp.	NSM	\$14.45	\$0.13	\$0.83	n.m.	17.4	538%	10.3
Avg. ex Intel					22.9	21.7		11.3

Source: Bloomberg, ScotiaMcLeod Inc.

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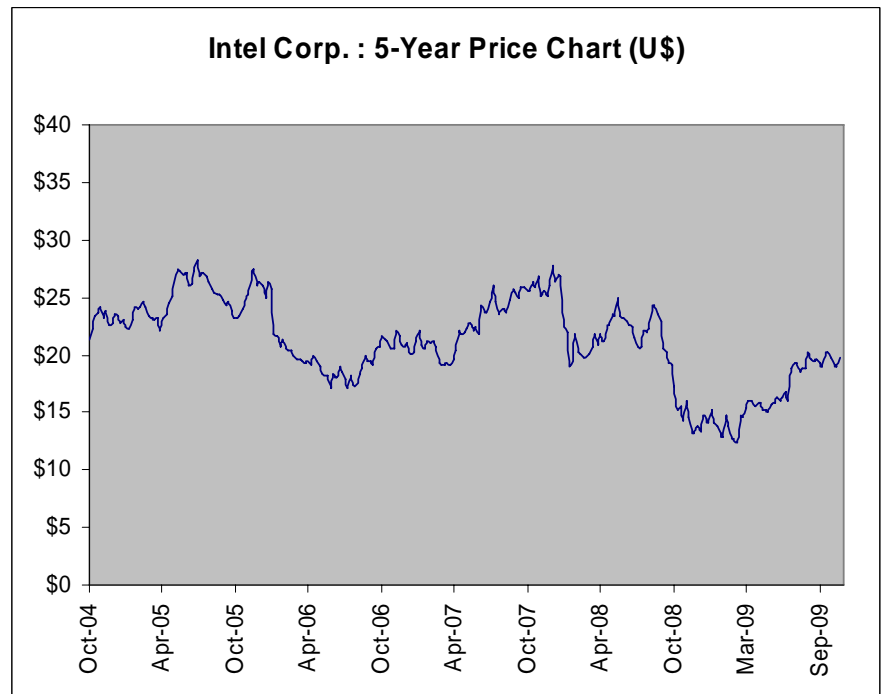
**Attractive Dividend Yield:** Intel has morphed into a cash cow supporting aggressive growth in its quarterly dividend over the last several years. Intel generated more than U\$2.8 billion in free cash flow in the third quarter of 2009. The shares offer a current dividend yield of 3.25%, one of the highest dividend yields in the S&P 500 technology sector.

### **Downside risks that may affect our outlook include:**

**Changes in Business and Economic Conditions:** A key element supporting our recommendation is an ongoing recovery in the global economy and inventory restocking. Intel has a high percentage of costs that are fixed or are difficult to reduce in the short-term. Another downturn in the economy as some economists are predicting could lead to a material shortfall in earnings relative to current expectations.

**Litigation Risk:** Intel is subject to legal claims or regulatory matters involving shareholders, competitors, and consumers. Unfavourable rulings against the company can lead to monetary damages that are quite material in some instances. Intel and AMD recently entered into an agreement to drop ongoing legal disputes worldwide. As part of this settlement, Intel will pay AMD U\$1.25 billion. The settlement eliminated a significant legal overhang from the stock.

**Competition:** The semiconductor market is highly competitive and technology changes rapidly. To compete, Intel must maintain a highly successful research and development effort, develop new products, and improve existing products ahead of competitors to sustain its 80% market share.



Source: Bloomberg

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*The author(s) of the report own(s) securities of the following companies.  
None.*

*The supervisors of the Portfolio Advisory Group own securities of the following companies.  
None.*

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