

Recommendation: HOLD

Estimated Fair Value: \$13-\$23*

1. Reasons for the Recommendation

The main reasons for the hold recommendation are based on the calculated per share range value, growth rates, and current revenues Intel has seen for their fiscal year 2011. Additional reasons include their PC Client Group performing well in emerging markets and investments on products they expect to be drivers in business for the future.

The year of 2010 was a record year for Intel in terms of revenues. Revenue increased 24% from its previous operating year of 2009. This large increase in revenue came from multiple factors: Intel improving their cost structure, resulting in lower manufacturing costs for their microprocessors and chip sets, higher average selling prices for microprocessors and more sales of microprocessors. The substantial growth in the PC market from the consumer and business side that Intel saw was the primary driver in their revenue. Gross margin also saw close to a 10% increase, coming from lower factory underutilization charges.

In emerging markets such as Latin America, Eastern Europe and China, PC's and laptops are becoming more affordable. Intel feels with these emerging markets, there is definite room for growth not only in revenue but for manufacturing. This is due to the differences in the demand for technology based products between the emerging markets and the U.S. While in the U.S. Intel is looking forward to the tablet and mobile phone market, in these other areas Intel expects major growth in PC and laptop use.

With the announcement coming from Meg Whitman at HP that they will not be exiting the PC and laptop market, Intel can look forward to maintaining a strong relationship with HP. HP is Intel's largest customer, creating 21% in 2010 (19% in 2009 and 2008) of revenue for Intel's PC Client Group. The re-addition of HP to the PC Client Group creates a threesome of companies heavily utilizing Intel's product in HP, Dell, and now Lenovo, which contributes close to the same amount of revenue as Dell, nearing 15%. Intel's PC Client Group accounted for 72% of Intel's total revenue in 2010. An exit from the PC market by HP could have reduced the PC Client Group revenue contribution to just above 50%, or \$22.5 billion, rather than \$31.4 billion.

In the last quarter Intel has seen increase in revenues coming from sales in the laptop and PC market, especially from emerging markets. Some of this increase in revenue has come from emerging markets and in part from one of their competitors, AMD, not being able to supply enough of their own chips from the increase in demand these emerging markets are developing. This issue was assisted by a glitch at a German AMD factory, disabling it to produce the amount of chips AMD needed, leading to the decrease in supply from AMD. AMD adjusted Q3 earnings from 10% down to 4-6% due to the German factory problems. This glitch can't be depended upon by Intel, since then AMD has corrected the issue and their factory is back to the operating power it once was. Though Intel sees more revenue stream come from their PC and laptop segment, they still see an increase in revenue in other segments such as their data center group which provides chipsets for servers.

Intel controls 80% of the PC and laptop market with the chipsets they provide to PC and laptop builders, and they are looking to enter new markets similar to the PC and laptop market. These markets include the mobile phone market and tablet market. Though Intel has seen increase in revenues from the PC and laptop market, they feel the market overall is slowing and transitioning to the mobile phone and tablet market. In their attempt to enter these markets, Intel has paired with Google to supply chipsets for both mobile phones and tablets that Google builds, but to also help in creating a smoother operating system for Google's mobile system, Android. With this pairing, Intel and Google look to take an upper hand over other mobile phone providers such as Microsoft, Blackberry, and most of all, Apple. Announcements from Intel indicate they are not only expecting their chip sets to appear in Google Android phones, but within multiple suppliers in the mobile phone market.

Intel still forecasts that the PC market will continue to grow, mainly from the emerging markets they see revenue from, but they are forecasting a much larger growth in the mobile phone and tablet market. Intel's transition into the tablet market looks to be a decision headed in the right direction, with tablet sales up 80% in Q2 2011 and 2011 sales expected to be 261%. They've also taken action on important opportunities to build itself more on the mobile phone and tablet market, rather than the slowing PC market to ensure continued growth. Intel provides servers for businesses that provide networking for mobile phones and tablets to receive the data they do, creating an increasing possibility for them to become a major player in the mobile phone and tablet market as far as hardware and connectivity is concerned.

Using multiples analysis, I've concluded Intel Corp. is undervalued. This conclusion comes from their multiples being below industry average and median, but sustaining a growth rate, profit margin and operating margin above industry average. Combined with the discounted cash flow calculations to arrive at the value per share range I've given, this leads me to believe the firm is fairly valued. With the estimated range of \$13 to \$23, in comparison to the market this suggests a slight over value to fair value along with multiples analysis suggesting the firm is undervalued. The combination of the estimated fair value and multiples analysis helps support my hold recommendation. Finally, using multiples analysis for Intel average historical performance in comparison to their current multiples, the market has undervalued the firm, with averages of P/E, P/B and P/S, being above their current values.

2. Company Analysis

Intel develops and builds semiconductor chips primarily for the communications and computing markets. These components are hardware such as motherboards, wireless and wired connectivity components, microprocessors and the hardware used to incorporate those components into an operable machine. Intel Corporation operates PC Client Group and Data Center Group as reportable segments. They also operate as non-reportable Embedded and Communications Group, Digital Home Group, and Ultra Mobility Group. As other operating segments Intel also operates NAND Solutions Group, Wind River Software Group, and Software and Services Group. These separate groups within Intel help organize and distribute their chip sets to different markets they are involved with. For example, their PC Client Group delivers their chip sets, processors, mother boards and other related components to the notebook and desktop market. Their Data Center Group delivers the same aforementioned product to wired network, workstation and server markets.

Intel's primary domestic competitors are AMD and IBM, along with a growing foreign competitor in Samsung Electronics. Intel competes through a broad range of PC, server, and networking hardware (chip sets) to deliver to manufacturers of these categories of products for final distribution to the public or for business use.

Their strategy is different compared to AMD in a way that AMD operates through only two segments, one for consumer/commercial chip sets that are within similar categories of Intel, but they also have a segment for graphics and multimedia products. AMD products are more specialized and optimized and marketed to a specific segment of the PC and laptop market. These chipsets are considered to be high performance chip sets for use within markets such as consumer PC and laptop gaming which requires a higher demand of graphic use, which AMD builds some of their chip sets for.

IBM operates within five segments, but is geared primarily towards the service and software side of the PC, server and networking markets. They are also heavily involved within IT. IBM has concentrated its products and services towards servers and IT intelligence to serve the business market. They provide high power servers to small and large businesses who require this type of product, as well as IT services to optimize the use of their servers to ensure requirements are met properly. IT provided is for software services to tie together their IT and servers through networking

Intel has recently been successful in entering the business services market with the acquisition of McAfee and Fulcrum Microsystems. McAfee is a security software and IT business concentrated in ensuring safety within networks and PC use. This acquisition was made in the early part of 2011. Intel made the acquisition primarily to deliver and incorporate security within systems, network, consumer, and endpoint systems that they build their chip sets for. In mid July Intel acquired Fulcrum Microsystems for primary reasons related to the silicon Fulcrum has developed for Ethernet switches. This silicon helps between lowering latency and balancing workloads which in turn maintains the network speeds Intel is looking to achieve. Not only will this help maintain the network speeds they are looking to maintain, but it will help Intel achieve the new levels of performance they are looking to gain as well as being energy efficient. This acquisition will lead to Intel's Ethernet switch connection running smoother and allowing for Intel's network users to maintain stability while operating on the Cloud, which Intel has developed and invested heavily in recently. The acquisition of Fulcrum compliments that of McAfee, with Intel attempting to make a strong move into the IT, server and business services market.

Intel operates in more areas compared to some of their closest domestic competitors. They have slowly begun to undertake more operations in order to develop more specialized and specific services and products to compete within more concentrated markets, such as high performance PC gaming and graphics.

3. Industry Analysis

Intel Corp. and its sub-industry are located within the Information Technology sector through GICS and Bloomberg. Overall, the IT sector includes businesses that are involved in developing software and services in areas such as the internet, systems, databases, and data processing. Other businesses also included in the IT sector handle manufacturing and distribution of hardware for computers, electronic equipment, hand held devices. Finally, it includes a third arm considered semiconductors and semiconductor equipment manufacturers, which Intel and its sub-industry or located within.

There are 14 companies that make up the sub-industry of the S&P 500 Semiconductors Index (S5SECO). The S&P Semiconductor group has a market capitalization of \$241.3 billion. Within the 14 companies are five that have a noticeably larger market cap than the others. They are Altera Corp. (\$11,527.94 billion), Analog Devices Inc. (\$9,836.53 billion), Broadcom Corp. (\$18,473.55 billion), Intel Corp. (\$116,362.20 billion), and Texas Instruments Inc. (\$31,447.83 billion). Texas Instruments recently acquired National Semiconductor in September of 2011.

The reason AMD and IBM were chosen as Intel's closest competitors is based off the primary reasons of chip sets that AMD provides to its end users and the services as far as networking and IT goes for IBM. Though Intel has not geared itself towards high performance graphics cards such as AMD has, AMD still has broader and more generalized chip sets and graphics cards that compete with Intel and the systems they are used in. IBM was primarily chosen due to Intel acquiring McAfee and looking to incorporate security services with the server platforms and networking they provide.

Other dominant firms within the sub-industry are Texas Instruments, Nvidia and Xilinx. These companies were not chosen as close domestic competitors due to specific reasons for each company. Texas Instruments does build some semiconductors, but it is also heavily involved with the design of them, and provides these products to companies that are within different end user markets than that of Intel.

With data being available beginning in 2003 for gross margin, operating margin, and profit margin, the sub-industry has seen positive growth rates for all three ratios. Gross margin has had an average growth rate of 1.42%, operating margin has had an average growth rate of 8.92% and profit margin has had an average growth rate of 17.09%, with these average rates being heavily influenced by the most recent year, 2010. Having positive, growing average rates for these three measures, it shows as a whole the industry has continued to be able to control the rate of increase/decrease in costs against its rate

of increase/decrease of sales. As a note for the average growth rates, average operating margin in 2010 was just below 32%, whereas from 2003 to 2008, it ranged between 21% and 26%.

Considering the outlook for the industry from this data provided and exit from the 2008-2009 period, the sub-industry as a whole can be seen to continue its profitability and high returns on returns on assets, equity and capital. The sub-industry could also end up having a fewer amount than 14 companies being listed in this index, due in part to acquisitions such as Texas Instruments and National Semiconductor. It is possible that other major players in the sub-industry will make acquisitions of the much smaller players taking into consideration fit and how the smaller players can benefit the larger companies in the industry.

***Methodology**

The range of \$13 to \$23 was derived from FCFE and DDM discounted cash flow models. The FCFE model arrived at the \$23 estimation while the DDM model arrived at the \$13 estimation. Growth rates were the same for both models, beginning at 22% for the first year of high growth periodically declining over five years to 5.64%, the nominal stable growth rate. High growth percentage was derived from the expected growth rate from the DDM method, taking into consideration the amount of money (\$6.6 billion in 2010) Intel spends on R&D. Finally, the equity reinvestment rate was derived from the FCFE model at 9.69%.

Appendix: Multiples

Comparable Firms

Intel Corp. & Competitors											
Firm	P/E (ttm)	Forward P/E	PEG Ratio	P/B	P/S	EV/EBI TDA	EV/Sales	Growth	ROE	Profit Margin	Operating Margin
AMD	4.03	9.45	1.17	2.4	0.64	5.75	0.67	10.43%	88.47%	15.98%	6.54%
BRCM	21.68	13.24	0.83	3.09	2.61	15.34	2.33	15.33%	16.88%	12.85%	12.65%
NVDA	16.54	13	0.99	2.4	2.38	8.43	1.75	14.98%	16.85%	14.65%	15.56%
IBM	14.51	12.41	1.22	9.9	2.07	9.08	2.25	11.50%	69.84%	14.68%	20.21%
TXN	13.26	13.7	1.36	3.23	2.57	8.22	2.86	10.36%	27.45%	20.82%	28.08%
ARMH	77.08	44.52	3.53	8.27	18.14	54.9	17.53	14.00%	11.56%	23.35%	29.11%
INTC	10.28	9.27	0.9	2.73	2.44	5.1	2.24	11.02%	27.21%	24.75%	32.77%
QCOM	22.37	14.21	0.87	3.64	6.94	13.42	5.71	16.36%	19.05%	28.48%	35.44%
ORCL	18.42	12.22	1.01	4.15	4.65	10.02	4.18	13.59%	24.50%	24.76%	36.79%
Average	22.02	15.78	1.32	4.42	4.72	14.47	4.39	13.06%	33.53%	20.04%	24.13%
Median	16.54	13.00	1.01	3.23	2.57	9.08	2.33	13.59%	24.50%	20.82%	28.08%

Sources: Google Finance and Yahoo! Finance

*growth rates are average growth rates from analysts covering the stock. The growth rate used in the DCF are based on fundamental growth rates.

Historical multiples

Historical Performance											
Firm	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	ttm
INTC	166.7	33.9	37.7	20.2	17.8	23.5	22.6	15.9	26.5	10.5	10.9
S&P 500	23.2	19.7	21.1	19.2	17.2	16.8	16.5	10.9	18.6	15.5	13.8
Firm	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	ttm
INTC	5.9	2.9	5.5	3.8	4.2	3.2	3.6	2.1	2.7	2.3	2.7
S&P 500	3.3	2.5	3.1	3.1	2.9	2.9	2.7	1.7	2.2	2.2	2
Firm	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	ttm
INTC	8.1	3.9	7	4.4	4	3.4	4.1	2.2	3.3	2.7	2.7
S&P 500	1.5	1.3	1.6	1.6	1.5	1.6	1.5	0.9	1.2	1.3	1.2

Source: Morningstar, Inc.