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Why Intel Deserves Another Look

By MARK VEVERKA

The world's No. 1 chip producer missed a lot of the opportunity in the smartphone game. But it has a new line of processors that could change that.

Intel is going mobile.

It's taken awhile. Shares of the world's largest producer of computer chips have been stuck in the mud in recent years because Intel (ticker: INTC) failed to adapt its high-powered chip architecture to the low-power needs of mobile processors. The dominant chips to date are based on the design of [ARM Holdings](#) (ARMH), whose long battery life made it the favorite for manufacturers of wireless devices such as smartphones and other mobile gadgets. But over the next several months, the Santa Clara, Calif.-based company, which has spent billions on the project, will see its Atom line of low-power chips showing up in more smartphones in India, China, France, the U.K., and the U.S.

Investors should be pleased.

"Intel will be a formidable competitor in the smartphone and tablet markets shortly with new design wins and alliances," says Los Angeles-based portfolio manager Todd Lowenstein, who runs a value-momentum fund for HighMark Capital Management, which oversees more than \$16 billion. "This is not in the stock, and investors effectively have a free option on potential success in those areas," he adds.



[Enlarge Image](#)

RamimnTalaie/Bloomberg News

Chief Executive Otellini believes computing is entering a "golden age" in which Intel will enjoy the "rarified air" available to those near the very top.

There's a lot at stake for Intel and Chief Executive Paul Otellini. "We are a leader in mobile, [but] we are just getting started," he recently told analysts at the company's annual investor meeting. Adds Intel Chief Financial Officer Stacy Smith in an interview with *Barron's*: "Our manufacturing leadership means we can make the best transistors in the world. We are targeting Atom to be a much lower-power, lower-cost architecture."

The lack of a compelling product has prevented Intel—and its stock—from getting more benefit from the explosion in mobile Internet use. The global

market for smartphones, fueled by **Apple's** (AAPL) iPhone, is expected to more than double to one billion units by 2015. While annual shipments of smartphones jumped 63% to 487.7 million units in 2011, personal-computer shipments (where Intel is dominant) rose a less eye-catching 14.8% to 414.6 million machines, according to Canalys, a mobile research firm. In all, global smartphone sales should hit \$150 billion by 2014.

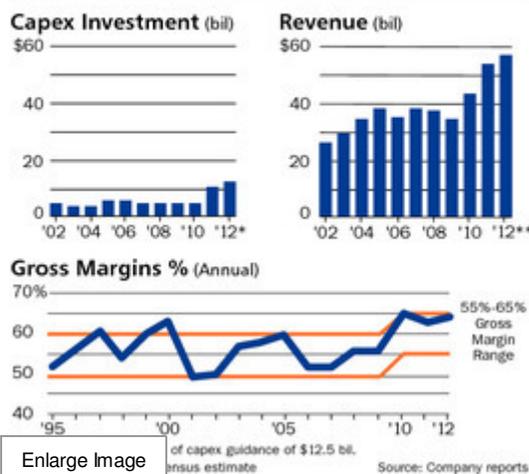
Intel didn't so much miss the boat on mobile as it opted not to jump on. It resisted the industry-standard ARM-based design and insisted on pushing its own x86 architecture, which is built more for speed and power than battery life. It also sold off another processor unit that had had some success in the early days of smartphones. Intel was betting that x86 would prevail.

The new push into mobile comes as Intel has been excelling in several other areas, including PCs, which many have written off as a dying business. Analysts expect its PC-related revenues, which account for 66% of total revenue, to grow in the single digits in 2012 fueled by 18% growth in China, Brazil, and other fast-growing markets. The chipmaker's upbeat view contrasts with last week's unsettling financial reports from PC bellwethers **Dell** (DELL) and **Hewlett-Packard** (HPQ). Their slump dinged Intel as its stock fell sharply before rebounding to \$25.74.

Intel has also been a big beneficiary of the cloud-computing boom. Data-center revenue has doubled over the past decade and accounts for about 20% of total revenues. As Internet data traffic explodes, so does the need for computer servers and storage. Storage providers such as **EMC** (EMC), **NetApp** (NTAP) and Hitachi Data Systems all use Intel processors in their arrays.

With a Chip on Its Outlook

Despite heavier outlays, Intel still is set for revenue increases and strong margins.



Enlarge Image

At the same time, Intel continues to build on its lead in supplying the brains behind high-performance computers, big-data appliances that manage huge sets of data, storage, and security through its McAfee software unit.

These successes have given Intel a rock-solid balance sheet. Revenue rose 24% to \$54 billion in 2011. Profit grew 13% to \$12.94 billion while earnings per share increased by 19% to \$2.39. Analysts expect 2012 EPS to rise about 5% to \$2.50 on revenue of \$57.14 billion. Despite heavier spending (see table, **With a Chip on Its Outlook**), Intel still expects gross operating margins to range between 60% and 65% in 2013, notes Edward Snyder, a managing director at Charter Equity

Research. Intel is sitting on \$7.1 billion in net cash and investments (*Barron's* lists other cash-rich companies in "**Show Us the Money**").

BULLS LIKE LOWENSTEIN argue that Intel's recent stock price doesn't reflect the company's PC growth in emerging markets, enthusiasm for cloud computing, and corporate spending on data-center infrastructure, including servers, storage, and networks. He thinks investors are too dismissive of the PC's future and are missing Intel's potential in mobile. "Misunderstood, undervalued, and out of favor, a combination we are drawn to as value investors," he says.

Last week's slight decline only makes Intel more of a bargain, according to Lowenstein. His 24-month

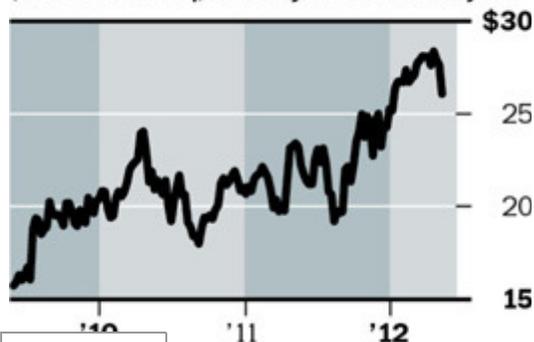
target is \$38-\$40. He notes that Intel's forward price/earnings multiple of 9.5 should be higher than the S&P's 11. **Qualcomm** (QCOM), in contrast, sports a P/E of 13.7. An added Intel perk: a dividend yield that tops 3%.

Smartphones aren't expected to aid Intel's books until the second half of 2013, but the broader category of mobile revenues already is moving in the right direction. Intel's mobile communications business, which includes its 2011 acquisition of the wireless business of Germany's **Infineon Technologies** (IFNNY), is expected to report \$4 billion in revenue this year and grow 37% to \$5.5 billion in 2013, says CFO Smith. Thanks to the Infineon deal, Intel already is a leader in radio-frequency processors—chips that broadcast frequency signals over wireless networks. Infineon has shipped more than 2.5 billion 2G and 3G radio chipsets—500 million of those since being acquired by Intel.

While unit revenue from mobile communications will contribute about 10% of 2012 revenue, its anticipated growth would be the payback for years of capital spending funded by Intel's PC dominance. The company currently has a four-year-lead in manufacturing-process technology, Snyder says. That means it would take that long for a rival to catch up to Intel's capabilities and cost efficiency, an expensive proposition. The company's big investment has resulted in a decreasing cost per transistor, a key metric in semiconductor manufacturing.

Intel

(INTC - Nasdaq) Weekly close on May 24



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Source: Thomson Reuters

These cost advantages should give Intel an edge in new areas of high-octane growth, such as Ultrabooks, tablets, and smartphones, and "will yield big results if the new markets catch fire," Snyder adds. Intel contends that Ultrabooks—the super-thin lightweight notebook computers it invented—may account for about 40% of all PC shipments by the end of this year and present a \$35 billion market opportunity over the next 12 months. The long-awaited shipment of the Windows 8 operating system, with touch-screen capability, later this year is fueling much of that optimism.

The global rollout of smartphones built on Google's Android operating system is under way. The first smartphone with Intel brains inside was launched last month by India's Lava International. This week, **China Unicom** (CHU), that country's third-largest carrier, follows with Intel smartphones made by **Lenovo** (992.Hong Kong). China's **ZTE** (763.Hong Kong) is also expected to introduce an Intel-based model later this year, with tablets to follow.

Orange, the wireless carrier unit of **France Telecom** (FTE), is unveiling its aptly named Santa Clara line of Intel-powered smartphones in its home market and the U.K. this summer, before bringing them to most of the rest of Europe.

The Orange phones were designed and built by Intel's mobile unit, led by co-head Michael Bell, formerly of Apple and Palm. The key was Intel's willingness to build and design its own "white box" smartphone (to which others can attach their brands), demonstrating to device makers and carriers that Atom could contend with ARM-based chips. "We knew it was a great product," Bell told *Barron's*.

Orange was so impressed with this sleek test model that it is selling it nearly as is. "This is one of the best products I've ever been associated with in my entire career," crows Bell. The influential tech blog, AnandTech, seemed to share his enthusiasm. The blog was skeptical that Intel was selling prototype phones to carriers, "but the device's fit and polish exceeded expectations."

The biggest and arguably most important product launch comes later this year from Motorola Mobility, now a unit of **Google** (GOOG). (Intel's Otellini sits on Google's board). Motorola agreed to a multiyear deal to produce smartphones and tablets using Atom processors. Intel now has 1,200 engineers working on Android-related projects.

The Bottom Line

Intel shares should get revalued as it powers more smartphones and other mobile devices. Two-year upside is \$38-\$40, about 50% above current levels.

Encouraging as these developments are, Intel has a long way to go before it can challenge Qualcomm and others for a slice of the biggest prize, Apple's business—something that Intel execs secretly covet. "We think we have a road map that will produce products everyone will have to look at," says Bell.

The advantage for Intel in these new ventures is all manufacturing processes and prowess. While lower-cost third-party chip-fabrication plants found success when PC-making became a commodity game, Intel's company-owned factories boasting integrated manufacturing processes were built for the next generation of computing. The company aims to dominate the mobile and cloud eras—producing the best chips across most major product segments at the lowest cost.

With the most modern fab plants costing as much as \$5 billion, Otellini is betting that few rivals can afford to keep pace. Computing is entering a "golden age" that will bring consolidation to the semiconductor industry, Otellini told analysts at a recent investors' confab. And in the end, he says, "Intel is going to be one of the companies on top, [and] it will be rarified air."

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