

Advanced Micro Devices (AMD)

3Q 2014: We Did Not Like the Answers We Got, Credit Profile to Worsen, Uncertainty Increases, Lowering Weighting

- Citi's Take** — We missed it. Dr. Su's sudden promotion to COO in June. Announced re-segmentation along with the COO promotion. Former CEO's comments in September that design wins could take longer than expected. AMD's abrupt CEO transition last week. We have materially lowered our 2015 forecasts owing to increased uncertainty, \$70 million new restructuring charges, and weak 4Q guidance. No direct 2015 guidance was provided. We were most concerned that the company's key growth segment, enterprise, embedded and semi-custom, could decline 20% year-over-year and 20% sequentially. AMD did announce \$1 billion design wins over three years which is expected add to revenue in 2016.
- Credit Implications** — Based on our revised forecasts, AMD leverage could rise from 3.9x to 6.3x in 2015. Our 2015 estimates show cash building owing primarily to reduced working capital. We expect AMD 2015 forecasts to vary widely, but believe our 16% sales decline reflects PC market challenges and surprising weakness in the enterprise, embedded and semi-custom business. We lower our weighting to Underweight owing to increased uncertainty and lower forecasts. We leave our Neutral ratings unchanged since our model shows cash generation, over \$1 billion cash, yields about 300bp wide to Citi's High Yield Technology index, and future potential design wins.

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Figure 1. AMD Credit Pricing

Cpn (%)	Description	Rating	Maturity	Moody's / S&P	Amt Out (\$mm)	Current Prices			YTW Date	Technology Index	BOND less Index (bp)
						Bid	YTW (%)	STW (bp)			
6.750	Sr Nts	Neutral	1 March 2019	B2(S) / B(P)	598	90.00	9.61%	826	1 March 2019	6.41%	320
7.750	Sr Nts	Neutral	1 August 2020	B2(S) / B(P)	500	90.00	10.07%	843	1 August 2020	6.41%	366
7.500	Sr Nts	Neutral	15 August 2022	B2(S) / B(P)	500	89.50	9.42%	748	15 August 2022	6.41%	301
7.000	Sr Nts	Neutral	1 July 2024	B2(S) / B(P)	500	83.00	9.75%	761	1 July 2024	6.41%	334

Source: Citi Research

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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3Q 2014 Highlights and Revisions

Conference Call Highlights

- Gaming revenue reached a seasonal peak in 3Q.
- AMD secured 2 design wins which have combined total lifetime revenue to contribute \$1 billion over three years, beginning in 2016.
- Wafer Supply Issues with GLOBALFOUNDRIES based on outlook? AMD is on track to meet requirements.
- Server market? A large addressable market, AMD is focused on some of the newer segments of the market (more ARM than x86).
- Semi-customer business is now all x86 based, but in the future expected to focus more on ARM.

Restructuring & Transformational Summary

AMD announced a restructuring plan as follows:

- Reduce headcount by 7% by year-end and reduce real estate footprint.
- Income statement charges: \$57 million in 4Q 2014, and \$13 million in 1H 2015.
- Cash charges: \$34 million in 4Q 2014, and \$20 million in 1H 2015.
- Savings guidance: \$9 million in 4Q 2014, and \$85 million in 1H 2015.

4Q Guidance

- Revenue: down 13% sequentially +/- 3% (\$1,243 million down 13%, \$1,200 million down 16%, \$1,286 million down 10%).
- Gross Margin: about 35%
- Operating Expenses: \$385 million
- 2014 free cash flow guidance: negative \$200 – 250 million including the \$200 million payment to GLOBALFOUNDRIES in 1Q 2014 and the \$34 million cash restructuring charge.

Projection Update

Figure 2. AMD Financial Summary

	Fiscal Year			Quarterly				LTM	Fiscal Year	
	12/31/11	12/31/12	12/31/13	3/31/14	6/30/14	9/30/14	12/31/14	9/30/14	12/31/14	12/31/15
	2011A	2012A	2013A	1Q14	2Q14	3Q14	E-4Q14	LTM	2014E	2015E
Operating Statistics										
Revenue	\$6,568	\$5,422	\$5,299	\$1,397	\$1,441	\$1,429	\$1,217	\$5,856	\$5,484	\$4,618
Sales Growth, Y/Y	1.1%	(17.4%)	(2.3%)	28.4%	24.1%	(2.2%)	(23.4%)	20.4%	3.5%	(15.8%)
Adjusted EBITDA	902	483	355	139	137	133	102	567	511	338
Margin	13.7%	8.9%	6.7%	9.9%	9.5%	9.3%	8.3%	9.7%	9.3%	7.3%
EBITDA Growth, Y/Y	(6.2%)	(46.5%)	(26.5%)	631.6%	211.4%	(0.7%)	(35.7%)	149.8%	43.8%	(33.8%)
Capital Expenditures	250	133	84	21	23	29	30	94	103	120
% Revenue	3.8%	2.5%	1.6%	1.5%	1.6%	2.0%	2.5%	1.6%	1.9%	2.6%
Cash & Equivalents	1,765	1,002	1,097	902	948	938	1,128	938	1,128	1,145
Total Secured Debt	0	23	71	70	69	69	14	69	14	14
Total Debt	2,016	2,042	2,058	2,140	2,211	2,211	2,156	2,211	2,156	2,114
Net Debt	251	1,040	961	1,238	1,263	1,273	1,028	1,273	1,028	969
Credit Statistics										
Total Debt / EBITDA	2.2x	4.2x	5.8x	4.5x	3.9x	3.9x	4.2x	3.9x	4.2x	6.3x
Net Debt / EBITDA	0.3x	2.2x	2.7x	2.6x	2.2x	2.2x	2.0x	2.2x	2.0x	2.9x

Source: Company Reports and Citi Research Estimates

- We lowered our forecasts to reflect continuing 15% declines in PC markets, a surprising 20+% decline in the company's growth markets, the new information that design wins will not benefit 2015, and aggressive cost actions. The design wins could add over \$300 million in sales beginning in 2016 which would represent about 7% of sales based on our 2015 estimates. AMD's aggressive cost actions and improved mix reduced the margin pressure that could have been expected otherwise.
- We lowered our 4Q estimates as follows: \$1,217 million sales (prior: \$1,542 million); and \$102 million EBITDA (prior: \$152 million).
- We lowered our 2015 estimates as follows: \$4,618 million sales (prior: \$5,841 million); \$338 million EBITDA (prior: \$614 million); 6.3x total leverage; and 2.9x net leverage.

3Q 2014 Review

AMD's \$1,429 million sales were below the \$1,473 million consensus and our \$1,473 million estimate. AMD re-segmented during the quarter which makes our segment comparisons not meaningful.

On a new segment basis, computing and graphics dropped 16% year-over-year, while enterprise, embedded and semi-custom jumped 20%.

Figure 3. AMD Revenue Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 2Q14	9/30/2014 3Q14	Change		9/30/2014 E-3Q14	Estimate vs Actual
				Y/Y	Q/Q		
Revenue	\$1,461	\$1,441	\$1,429	(\$32) -2.2%	(\$12) -0.8%	\$1,473	\$44 3.1%
Change							
Computing and Graphics	\$925	\$828	\$781	(\$144) -15.6%	(\$47) -5.7%		
Change							
Enterprise, Embedded and Semi-Custom	\$536	\$613	\$648	\$112 20.9%	\$35 5.7%		
Change							

Source: Company Reports and Citi Research Estimates

AMD's \$133 million EBITDA was in-line with consensus \$134 million estimate, but below our \$152 million forecast. AMD missed our forecasts owing to gross margins which were 29bp below our expectations.

Figure 4. AMD EBITDA Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 2Q14	9/30/2014 3Q14	Change		9/30/2014 E-3Q14	Estimate vs Actual
				Y/Y	Q/Q		
Revenue	\$1,461	\$1,441	\$1,429	(\$32) -2.2%	(\$12) -0.8%	\$1,473	\$44 3.1%
Change							
Adjusted EBITDA	\$134	\$137	\$133	(\$1) -0.7%	(\$4) -2.9%	\$152	\$19 14.0%
Change							
EBITDA Margin (%)	9.2%	9.5%	9.3%	14 bp	-20 bp	10.3%	98 bp 10.5%
Change							
Gross Profit	\$521	\$498	\$494	(\$27) -5.2%	(\$4) -0.8%	\$514	\$20 4.0%
Change							
Adjusted Gross Margin (%)	34.4%	34.6%	34.6%	21 bp	1 bp	34.9%	29 bp 0.8%
Change							
R&D	\$288	\$277	\$278	(\$10) -3.5%	\$1 0.4%	\$278	\$0 0.0%
Change							
R&D (% of revenue)	19.7%	19.2%	19.5%	-26 bp	23 bp	18.9%	-58 bp -3.0%
Change							
SG&A	\$155	\$154	\$150	(\$5) -3.2%	(\$4) -2.6%	\$157	\$7 4.7%
Change							
SG&A (% of revenue)	10.6%	10.7%	10.5%	-11 bp	-19 bp	10.7%	16 bp 1.5%
Change							
Depreciation & Amortization	\$57	\$53	\$49	(8) -14.0%	(4) -7.5%	\$53	4 8.2%
Change							
Stock Compensation Costs	\$23	\$21	\$21	(2) -8.7%	0 0.0%	\$24	3 14.3%
Change							

Source: Company Reports and Citi Research Estimates

AMD's free cash flow was negative \$11 million in the quarter and decline \$17 million year-over-year. Our model had forecast better working investment cycle which could have contributed \$90 million positively versus the actual \$51 million usage.

Figure 5. AMD Cash Flow Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 2Q14	9/30/2014 3Q14	Change		9/30/2014 E-3Q14	Estimate vs Actual
				Y/Y	Q/Q		
Adjusted EBITDA Change	\$134	\$137	\$133	(\$1) -0.7%	(\$4) -2.9%	\$152	\$19 14.0%
Operating Cash Flow Change	\$21	(\$28)	\$18	(\$3) -14.3%	\$46 -164.3%	\$192	\$174 965.6%
Capital Expenditures Change	\$15	\$23	\$29	\$14 93.3%	\$6 26.1%	\$30	\$1 3.4%
Operating Cash Flow less Capex Change	\$6	(\$51)	(\$11)	(\$17) -283.3%	\$40 -78.4%	\$162	\$173 -1571.4%
Change in Working Investment Change	(\$242)	(\$95)	(\$51)	\$191 -78.9%	\$44 -46.3%	\$90	\$141 -276.0%

Source: Company Reports and Citi Research Estimates

AMD's leverage remained 3.9x sequentially with cash and debt nearly flat as well.

Figure 6. AMD Leverage Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 2Q14	9/30/2014 3Q14	Change		9/30/2014 E-3Q14	Estimate vs Actual
				Y/Y	Q/Q		
Adjusted EBITDA Change	\$134	\$137	\$133	(\$1) -0.7%	(\$4) -2.9%	\$152	\$19 14.0%
Cash & Equivalents Change	\$1,060	\$948	\$938	(\$122) -11.5%	(\$10) -1.1%	\$1,110	\$172 18.3%
Total Secured Debt Change	\$20	\$69	\$69	\$49 245.0%	\$0 0.0%	\$69	\$0 0.0%
Total Debt Change	\$2,049	\$2,211	\$2,211	\$162 7.9%	\$0 0.0%	\$2,211	\$0 0.0%
Net Debt Change	\$989	\$1,263	\$1,273	\$284 28.7%	\$10 0.8%	\$1,101	(\$172) -13.5%
Total Secured Debt / EBITDA Growth	0.1x	0.1x	0.1x	0.0x 38.1%	0.0x 0.2%	0.1x	0.0x -3.2%
Total Debt / EBITDA Growth	9.0x	3.9x	3.9x	-5.1x -56.8%	0.0x 0.2%	3.8x	-0.1x -3.2%
Net Debt / EBITDA Growth	4.4x	2.2x	2.2x	-2.1x -48.5%	0.0x 1.0%	1.9x	-0.4x -16.2%

Source: Company Reports and Citi Research Estimates

Figure 7. AMD Capital Structure & Liquidity

	9/30/14 3Q14	Gross Leverage	Net Leverage	Bid		YTW Date	Rating
				Price	YTW		
Cash & Equivalents	938						
\$500M ABL, L+225bp due 11/12/2013	55						
Capital Leases	14						
Total Secured Debt	69	0.1x	-1.5x				
6.0% Sr. Converts due 5/1/2015	42						
6.750% Sr. Notes due 3/1/2019	600			90.000	9.61%	3/1/2019	Neutral
7.75% Sr. Notes due 8/1/2020	500			90.000	10.07%	8/1/2020	Neutral
7.5% Sr. Notes due 8/15/2022	500			89.500	9.42%	8/15/2022	Neutral
7% Sr. Notes due 12/31/2024	500			83.000	9.75%	7/1/2024	Neutral
Capital Leases	14						
Unamortized Debt Discounts / Other	0						
Total Debt	2,211	3.9x	2.2x				
Market Equity Value	2,021		3.6x				
less: Cash & Cash Equivalents	(938)						
Enterprise Value	3,294		5.8x				
Liquidity							
Cash & Equivalents	938						
Availability Under Revolver	445						
Total	1,383						

Source: Company Reports and Citi Research Estimates

Appendix A-1

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Data current as of 30 Sep 2014			
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% of companies in each rating category that are investment banking clients	71%	79%	65%

Advanced Micro Devices Inc (AMD) — Issuer Portfolio Weighting and Issue Rating History

High Yield Credit Research

Analyst: David Phipps

Issuer		Issue			
Weighting	Date	Coupon	Description	Maturity	Rating
UW	05-Oct-12	8.125%	Sr Nts	15-Dec-17	Sell (3)
MW	16-Oct-13				Neutral (2)
					Sell (3)
					NC
		7.750%	Sr Nts	01-Aug-20	Sell (3)
					Neutral (2)
					Buy (1)
					Neutral (2)
		7.500%	Sr Nts	15-Aug-22	Sell (3)
					Neutral (2)
					Sell (3)
					Neutral (2)
					Buy (1)
					Neutral (2)
		6.750%	Sr Nts	01-Mar-19	Buy (1)
					Neutral (2)
		7.000%	Sr Nts	01-Jul-24	Buy (1)
					Neutral (2)

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