



Advanced Micro Devices Inc. (AMD)

Updated July 7th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$32	5 Year CAGR Estimate:	-0.4%	Volatility Percentile:	99.3%
Fair Value Price:	\$16	5 Year Growth Estimate:	12.0%	Momentum Percentile:	99.3%
% Fair Value:	194%	5 Year Valuation Multiple Estimate:	-12.4%	Growth Percentile:	95.1%
Dividend Yield:	0.0%	5 Year Price Target	\$29	Valuation Percentile:	1.5%
Dividend Risk Score:	NA	Retirement Suitability Score:	NA	Total Return Percentile:	4.4%

Overview & Current Events

Advanced Micro Devices was founded in 1959 and in the decades since its beginning, it has become a sizable player in the chip market. AMD is heavy in gaming chips, competing with others like NVIDIA for the lucrative, but competitive market. AMD enjoys nearly \$7 billion in annual revenue and has a current market capitalization of \$34 billion following a massive rally in the stock. AMD does not pay a dividend.

AMD reported Q1 earnings on 4/30/19 and results beat expectations on the top line, while meeting consensus for earnings-per-share. Revenue came in 23% lower year-over-year as the massive cyclicity in AMD's results showed once again. Computing and Graphics revenue was \$831 million, down 26% against the year-ago period on lower graphics channel sales. Enterprise Embedded revenue came to \$441 million, a 17% decline against last year's Q1 as lower semi-custom revenue weighed.

Gross margin improved markedly, rising from 36% of revenue to 41% year-over-year thanks to the ramp-up of the Ryzen CPU line and EPYC server processor strength. However, operating expenses rose 11%, which helped send operating income down by roughly half, as expenses rose significantly as a percentage of revenue. Earnings-per-share came in at \$0.06 against \$0.11 in the year-ago period.

Revenue for Q2 was guided at ~\$1.5 billion and gross margin is expected to be 41%, as it was in Q1. Our initial estimate for earnings-per-share for this year is \$0.65, representing significant growth against 2018. We see improved margins as a big driver of improved earnings, but also, improved revenue performance in Q2 and beyond after a somewhat weak Q1.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	-\$1.42	\$0.49	\$0.50	-\$0.16	-\$0.11	\$0.06	-\$0.54	-\$0.14	\$0.17	\$0.46	\$0.65	\$1.15
DPS	---	---	---	---	---	---	---	---	---	---	---	---
Shares	671	683	698	741	754	768	792	935	967	1,005	1,075	1,200

AMD has struggled in the past with breaking even, let alone producing earnings growth. Indeed, in the past decade, the company has posted full-year losses five times. In addition, its cumulative earnings-per-share since 2009 is -\$0.69. That sort of dismal track record with earnings means we wouldn't typically be particularly bullish on future growth. However, AMD's cyclicity is working well for it today as it enjoys a powerful upward swing. For this reason, we see 12% annual earnings-per-share growth in the coming five years. However, we note that AMD's tremendous cyclicity can turn rather quickly, so our growth forecast carries a much larger margin for error than for other companies.

We see significant revenue growth as the main driver of improving earnings in the coming years (with margin growth playing a big role in 2019). This year should see revenue up in the mid-single digits, while new product launches should see AMD enjoy a ~20% sales increase next year. Improved gross margins on new products should also help boost profitability over time, provided AMD can keep its operating expenses in check. This business requires constant investment for the next phase of growth, and AMD finds itself there today.

Potential risks include failure of new product launches, a general downturn in demand from AMD's customers, and the company's significant, constant dilution. AMD's share count is up from 671 million in 2009 to in excess of a billion shares

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today. The company issues stock as a way of life and thus, we see this continued headwind crimping earnings-per-share growth in the coming years, even if our robust growth forecast comes to fruition.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	16.2	14.3	---	---	---	---	---	---	37.4	48.5	25.0
Avg. Yld.	---	---	---	---	---	---	---	---	---	---	---	---

AMD hasn't been profitable consistently enough in the past decade to warrant valuing it on earnings for any reasonable period of time. However, the company seems to have turned the corner and should be profitable for the foreseeable future. The issue is that the stock is currently pricing in many years of earnings growth and thus, we find it very overpriced. The current price-to-earnings ratio of 48.5 is nearly double our still-optimistic fair value estimate of 25 times earnings. Given this, we see a 12.4% annual headwind to total returns in the coming years.

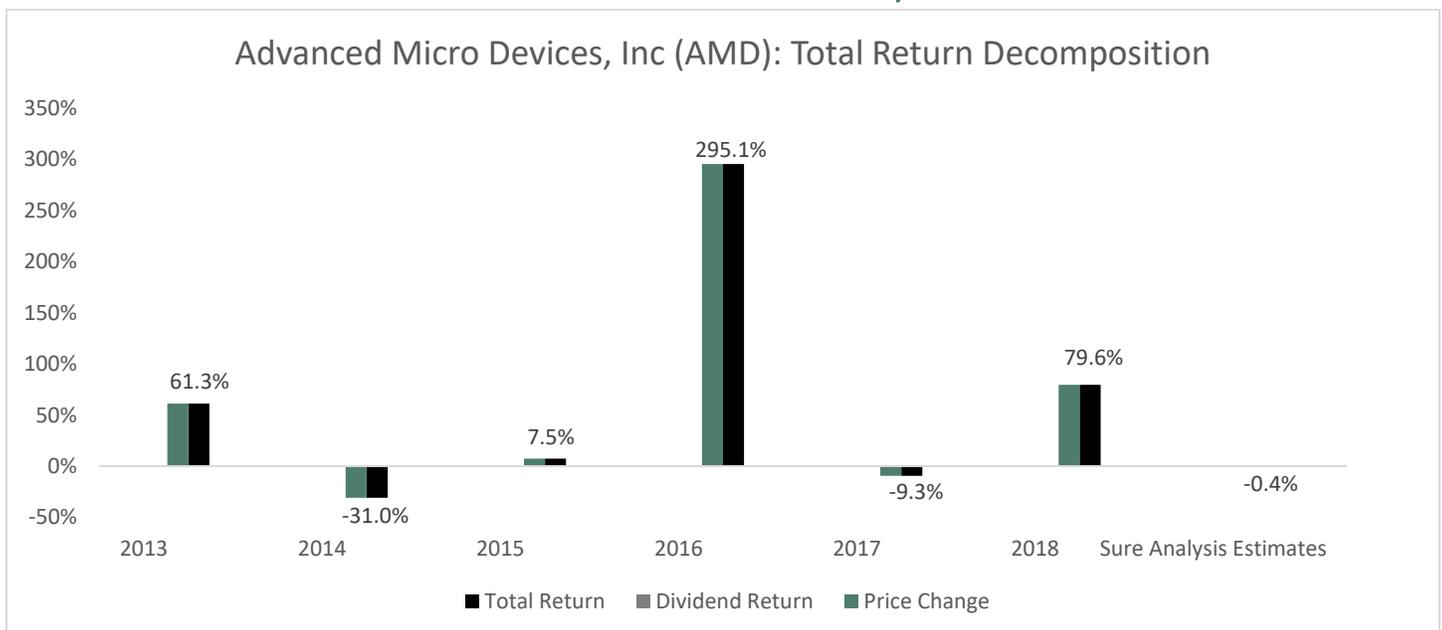
Safety, Quality, Competitive Advantage, & Recession Resiliency

AMD's competitive advantage is in its world class gaming chips, although some of that advantage has been eroded in recent years due to better entrants from competitors like NVIDIA. We see AMD as one of the weaker chip makers, and indeed, historical earnings suggest this is the case. Given the cyclical nature of demand for AMD's products, as well as the discretionary nature of gaming chips, we see AMD as very susceptible to recessions. Indeed, its earnings suffered massively during the Great Recession, and we see that as likely being the case during the next downturn as well.

Final Thoughts & Recommendation

With the stock being up by 70% already this year, AMD looks tremendously overvalued. We see total annual returns of -0.4% in the coming years, thanks to 12% earnings-per-share growth being nearly entirely offset by a much lower valuation. AMD is one of the most expensive stocks in our coverage universe and as such, we rate it a sell. The risk of owning AMD at today's price is far too great and the potential reward far too little to consider owning it. The stock is up ~1,700% in the space of three years, and we see this as pricing in far too much growth.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	5403	6494	6568	5422	5299	5506	3991	4319	5253	6475
Gross Profit	2272	2961	2940	1235	1978	1839	1080	1003	1787	2447
Gross Margin	42.1%	45.6%	44.8%	22.8%	37.3%	33.4%	27.1%	23.2%	34.0%	37.8%
SG&A Exp.	994	934	992	823	674	604	482	466	516	562
D&A Exp.	1128	383	317	260	236	203	167	133	144	170
Operating Profit	664	561	466	-956	85	149	-352	-383	127	451
Operating Margin	12.3%	8.6%	7.1%	-17.6%	1.6%	2.7%	-8.8%	-8.9%	2.4%	7.0%
Net Profit	376	471	491	-1183	-83	-403	-660	-498	-33	337
Net Margin	7.0%	7.3%	7.5%	-21.8%	-1.6%	-7.3%	-16.5%	-11.5%	-0.6%	5.2%
Free Cash Flow	7	-560	132	-471	-232	-193	-322	4	-101	-129
Income Tax	112	38	-4	-34	9	5	14	39	18	-9

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	9078	4964	4954	4000	4337	3767	3084	3321	3552	4556
Cash & Equivalents	1657	606	869	549	869	805	785	1264	1185	1078
Accounts Receivable	745	968	919	630	832	818	533	311	454	1235
Inventories	567	632	476	562	884	685	678	751	694	845
Goodwill & Int. Ass.	421	360	331	804	911	604	467	523	528	515
Total Liabilities	7354	3951	3364	3462	3793	3580	3496	2905	2956	3290
Accounts Payable	647	581	363	278	519	415	279	440	384	528
Long-Term Debt	4731	2421	2016	2042	2058	2212	2237	1435	1395	1250
Shareholder's Equity	648	1013	1590	538	544	187	-412	416	596	1266
D/E Ratio	7.30	2.39	1.27	3.80	3.78	11.83	-5.43	3.45	2.34	0.99

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.5%	6.7%	9.9%	-26.4%	-2.0%	-9.9%	-19.3%	-15.6%	-1.0%	8.3%
Return on Equity	97.0%	56.7%	37.7%	-111%	-15.3%	-110%		-24900%	-6.5%	36.2%
ROIC	6.5%	9.5%	13.9%	-38.2%	-3.2%	-16.1%	-31.3%	-27.1%	-1.7%	15.0%
Shares Out.	671	683	698	741	754	768	792	935	967	1,005
Revenue/Share	7.97	8.86	8.85	7.32	7.03	7.17	5.10	5.17	5.52	6.09
FCF/Share	0.01	-0.76	0.18	-0.64	-0.31	-0.25	-0.41	0.00	-0.11	-0.12

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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