Intel 2Q Preview: Revenue Downside Risk, EPS More Sheltered

Intel *(INTC, $24.25 +0.31, Hold/Not Compelling, Target $24, CY13: $1.84 on $53.44B, CY14: $2.12 on $57.93B)*
Downside Risk for 2Q13: INTC is scheduled to announce 2Q earnings after the close today and I believe the company is at risk of missing expectations primarily due to deteriorating PC market conditions. Specifically, I believe revenue is at risk of downside while EPS upside potential is unlikely for both the reported 2Q and forward guidance. My revenue and EPS estimates for 2Q and 2013 are just below those of consensus, and I would not be surprised to lower my revenue expectations after the announcement, although EPS is more likely to be flat to slightly down due to a variety of factors under greater management control.

With PC business accounting for over 60% of sales, INTC simply does not have enough of anything else to offset weakness in that space. Hence, revenue is at considerable risk, in my opinion. However, EPS can be sheltered from this weakness—to a degree—by a number of factors, including gross margin, operating expenses, interest and other income, tax rates, and share count. Gross margin actually benefits from lower PC sales since more profitable sever-related business would then become a greater portion of total revenue. Operating expenses for over 100,000 employees totaling some $19B this year are very much under direct managerial control and have been effectively controlled throughout the history of the organization to preserve profitability. Interest and other income is very difficult to forecast as an outsider, and while interest rates are very low the company usually seems to discover at least a couple hundred million dollars worth of such benefits every year. Management has been notorious for over-forecasting tax rates as long as I have been modeling the company (15-ish years?), and seems to have an on-going stream of disputes for which it prevails. And its mostly-regular repurchase of $1B in shares each quarter has been at least slowly trimming its share count over the last couple of years. While I am very uncomfortable with the revenue prospects for the company at this point in time, I am much less uncomfortable with its demonstrated ability to preserve and extend EPS.

Management guidance going into the period called for revenue of $12.9B +/-500M, or +2.5% sequentially with a range of -1.4% to +6.5%, and my revenue and EPS estimates, consensus and range are detailed in the tables below. The shares are currently trading at my 12-month target price of $24 and I consider downside risk to be greater than upside potential in the near-term due to PC market weakness and the likelihood of lowered estimates. Nevertheless, I also think the annual dividend yield of 3.7% as well as management's ability to shelter a meaningful portion of EPS from expected revenue weakness could very well limit the magnitude of that potential downside risk. I continue to recommend the shares as Hold/Not Compelling.

Diluted EPS, GAAP	2Q13	2013	2014
Tokeneke	*$0.38*	*$1.84*	*$2.12*
Consensus	$0.39	$1.87	$2.02
Highest Estimate	$0.43	$2.05	$2.51
Lowest Estimate	$0.36	$1.62	$1.60

Revenue,40 estimates	2Q13	2013	2014
Tokeneke	*$12,750*	*$53,444*	*$57,928*
Consensus	$12,890	$53,480	$55,600
Highest Estimate	$13,000	$56,080	$63,000
Lowest Estimate	$12,700	$51,880	$49,330

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