Recovering PC Market Makes Intel Still A Buy

Click here to subscribe to our research

Intel (INTC: ~$31/share) has been on a tear since the company raised its second quarter revenue forecast recently and projected year over year sales growth in its PC Client Group for the first time since 2011.

INTC's guidance on the PC Client Group backs up my case from last November, when I argued that INTC was undervalued and the PC market would stabilize. It appears the PC market has stabilized, but is INTC, up 25% since November, still undervalued?

Mobile Is Still A Worry

My bullish thesis for INTC's profits going forward rested on three points: (A) PC sales would stabilize, (B) mobile was a big growth opportunity, and (C) the Data Center Group would continue to be a steady source of cash flow and growth.

So far A appears to be confirmed and nothing has happened to suggest that C is untrue. However, Intel continues to struggle with execution on the mobile front. Significant mobile design wins, once thought to come in 2014, now look more likely to come in late 2015 or early 2016 at the soonest.

Encouragingly, however, INTC has clearly not given up on this large growth market and continues to spend heavily on R&D in order to break into the mobile business. In the first quarter of 2014, INTC spent 22% of revenue on R&D, up from 20% the year before.

INTC has been woefully late to the game in mobile, that much is indisputable, but its continued investment in R&D makes me believe the company will eventually carve out a meaningful market share. INTC's brand, technical expertise, and significant resources should be enough to take a slice of the market from incumbents like Qualcomm (QCOM).

The smartphone and tablet processor market is around $20 billion and still growing rapidly, so even if INTC can only grab a minor share its mobile segment can meaningfully contribute to the bottom line.

Even Without Mobile, INTC is in Decent Shape

Key to my bullishness on INTC is the fact that, even if mobile is a failure, the stock is priced reasonably. Its current valuation of ~$31/share gives it a price to economic book value ratio (PEBV) of 1.1. This ratio implies that INTC will never grow after tax profit (NOPAT) more than 10% from its current level. Even with the recent upside move, the market has low expectations for INTC.

Even if mobile fails to drive significant growth, INTC has the potential to go higher. If INTC can grow NOPAT by 5% compounded annually for 15 years, the stock has a fair value of ~$41/share today, a 34% upside. This expectation is reasonable considering the company has grown NOPAT at 6% compounded annually over the past 10 years.

Not a Screaming Buy Like Before

I still like INTC, but not as much as I did in November. Back then, I suggested the stock could have as much as 100% upside from its then-valuation of ~$25/share. The increase in INTC's valuation and the struggles in its mobile segment have tempered my enthusiasm, and as per above the upside for INTC is probably ~30% now. INTC has also been downgraded from Very Attractive to Attractive by my stock rating methodology. INTC is still a good stock for a value investor, but it's not as great as it was eight months ago.

Funds that Hold INTC

Investors looking for exposure to INTC through a fund should look at these nine ETFs and mutual funds that allocate at least 5% to INTC and earn our Attractive-or-better rating.

Sam McBride contributed to this report.
Disclosure: David Trainer and Sam McBride receive no compensation to write about any specific stock, sector or theme.

New Constructs® – Profile

How New Constructs Creates Value for Clients

1. **Superior Recommendations** – Our stock picks consistently outperform. See our track record in our stock-picking accolades and Proof Is In Performance reports.
2. **More Accurate Research** – Our patented Research Platform for reversing accounting distortions and discounted cash flow analysis leverages better data to deliver smarter research.
3. **Time Savings** – We check the fine print in thousands of corporate filings so you don't have to. As reported by Barron's, our expertise in analyzing SEC filings delivers Hidden Gems and Red Flags that drive long-term stock-picking success.
4. **Transparency** – We are proud to share the results of our analysis of over 50,000 10Ks. Request the Corporate Disclosure Transgressions report we provided the SEC. Our reports detail all data and assumptions. Company Models enable users to change them.
5. **Objectivity** – New Constructs is an independent research firm, not tied to Wall Street or investment banking services. Our models are driven by comprehensive high-quality data not stories. See our presentation to the Senate Banking Committee, the SEC and many others in DC.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

Additional Information

Incorporated in July 2002, New Constructs is an independent publisher of investment research that provides clients with consulting, advisory and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. NOPAT, Invested Capital, and WACC, to create economic earnings models, which are necessary to understand the true profitability and valuation of companies. Visit the Free Archive to download samples of our research. New Constructs is a BBB accredited business and a member of the Investorside Research Association.

DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first 15 days after New Constructs issues a report on that security.

New Constructs is affiliated with Novo Capital Management, LLC, the general partner of a hedge fund. At any particular time, New Constructs' research recommendations may not coincide with the hedge fund's holdings. However, in no event will the hedge fund receive any research information or recommendations in advance of the information that New Constructs provides to its other clients.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.