



## Stock Pick of the Week: Intel Corporation (INTC)

It feels as if the longer interest rates remain depressed, the crazier company valuations become. As investors scramble to find returns in this stretched market, some are turning to IPOs, private equity, and other risky, often speculative investments. This makes finding quality stocks even harder. When valuations get out of touch with reality, it can be beneficial to look at companies that tend to get lost in all the noise. We're talking about large, mature companies that, while not growing at breakneck speeds, churn out consistent profits and create long-term shareholder value. This week's stock pick of the week, Intel (INTC), accomplishes just that.

### What is Intel Doing?

Intel designs, manufactures, and sells integrated digital technology platforms. The company focuses on computing devices and is possibly best known for its processors for desktop computers, laptops, ultraportable devices, and mobile devices. The company is also directing its efforts toward data centers and now provides products for server, network, storage, and cloud computing platforms. Intel also develops technologies for use in numerous Internet of Things (IoT) related applications.

### Why Invest Now?

Since early January, Intel shares have been undeservedly under selling pressure, pushing the stock down 19% on the year near the end of March. Much of this pressure was due to Intel warning of lower than expected PC sales having an adverse effect on overall results. However, these "adverse effects" were not nearly as bad as the market's reaction would have you believe, and the drop in share price has created an excellent investment opportunity in Intel.

### What About Intel's Underlying Fundamentals?

In 2014, Intel saw slight revenue growth and impressive after tax profit ([NOPAT](#)) growth. Revenues grew 6% over 2013 and NOPAT increased 24% year over year. Intel increased its return on invested capital ([ROIC](#)) to a top quintile 20% in 2014, up from 17% the prior year. Intel also generated over \$7.3 billion in [free cash flow](#) in 2014 and had a FCF yield of 4%.

Intel's strong NOPAT growth in 2014 coincided with its increasing NOPAT margin, up to 21% from 18% in 2013.

The supposedly "disappointing" 1Q15 earnings report was also much to do about nothing. Intel reported that overall revenues in the quarter were unmoved from the prior year. However, the weakness in Intel's Client Computing Group was more than offset by strong growth in other segments. The Data Center Group saw revenues grow 19%, while IoT segment revenues increased 11%. The growth of these two segments will be paramount for Intel going forward as the global PC market is expected to continue its low to negative overall growth. When combined, these two segments accounted for 33% of Intel's revenue in 1Q15.

On top of strong growth in the two segments noted above, Intel was able to increase its gross margin to 61%. Despite the lowered guidance, Intel's overall business is continuing to chug along, albeit slower than initially expected. The worries from the beginning of this year could very well be short-term concerns. It will be up to management to capitalize on the Data Center and IoT businesses and so far they are proving more than capable of doing so.

### We Made These Adjustments to Intel's Operating Profitability and Valuation

We make several key adjustments to the earnings and balance sheets of companies to uncover the recurring cash flows of each company's core business and the value left for shareholders. We made the following adjustments to Intel's earnings in 2014:

- Removed \$151 million in [non-operating expense hidden in operating earnings](#).
- Removed a net of \$81 million in [reported non-operating items](#).



When considering Intel's valuation, we also added \$902 million in [off-balance sheet debt](#) (5% of debt) from operating leases to Intel's total debt.

### **The Buying Opportunity is Now**

As mentioned above, Intel's stock price has unjustly run down over the course of the year and we believe current share prices present a great buying opportunity. At its current price of \$32/share, INTC has a price to economic book value ([PEBV](#)) ratio of only 0.9. This ratio implies that the market expects Intel's NOPAT to permanently decline by 10% from current levels. Given that Intel grew NOPAT by over 20% in 2014 alone, we believe the market's expectations are too pessimistic.

If Intel can [grow NOPAT by just 5% compounded annually for the next seven years](#), the stock is worth \$42/share today — a 31% upside. With such low expectations embedded into this quality company, it's easy to see why Intel earns our Very Attractive rating and made our [Most Attractive Stocks list in May](#).

*Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, style, 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. See 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 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.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs.

Copyright New Constructs, LLC 2003 through the present date. All rights reserved.