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AMD - Q1 2013 Advanced Micro Devices Earnings Conference Call

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OVERVIEW:

AMD reported 1Q13 revenue of \$1.09b, non-GAAP net loss of \$94m and non-GAAP loss per share of \$0.13. Expects 2Q13 revenue to increase 2% sequentially, plus or minus 3%.



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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. My name is Huey, and I'll be your conference operator for today. At this time, I'd like to welcome everyone to AMD's first-quarter 2013 earnings conference call. All lines have been placed on a listen-only mode at this time. After the speakers' remarks, you will be invited to participate in a question-and-answer session. As a reminder, this conference is being recorded today.

I would now like to turn the conference over to Ms. Ruth Cotter, Vice President of Investor Relations for AMD. Please go ahead.

Ruth Cotter - *Advanced Micro Devices, Inc. - VP of IR*

Thank you, and welcome to AMD's first-quarter earnings conference call. By now, you should have had the opportunity to review a copy of our earnings release and the CFO commentary and PowerPoint slides. If you've not reviewed these documents, they can be found on AMD's website at quarterlyearnings.amd.com.

Participants on today's conference call are Rory Read, our President and Chief Executive Officer; Devinder Kumar, our Senior Vice President and Chief Financial Officer; and Lisa Su, our Senior Vice President and General Manager, Global Business Unit, who will be present for the Q&A portion of the call. This is a live call, and will be replayed via webcast on amd.com.



I'd like to highlight a few dates for you. Mark Papermaster, our Senior Vice President and Chief Technology Officer, will present at the Jefferies Global Technology Internet Media and Telecom conference on May 7 in New York. Andrew Feldman, Corporate Vice President and General Manager, Server Business Unit, will present at the JPMorgan Technology Media and Telecom Conference on May 15 in Boston. Our second-quarter quiet time will begin at the close of business on Friday, June 14. And lastly, we intend to announce our second-quarter earnings on July 18 of this year. Dial-in information for the call will be provided in mid-June.

Please note, non-GAAP financial measures referenced during this call are reconciled to their most directly comparable GAAP financial measures in the press release and CFO commentary posted on our website at quarterlyearnings.amd.com.

Before we begin, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it. Those statements are based on current beliefs, assumptions, expectations; speak only as of the current date; and, as such, involve risks and uncertainties that could cause actual results to differ materially from our current expectations. Please refer to the cautionary statement in our press release for more information. You'll also find detailed discussions about our risk factors in our filings with the SEC and, in particular, AMD's annual report on Form 10-K for the year ended December 29, 2012.

Now, with that, I'd like to hand the call over to Rory. Rory?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Thank you, Ruth. First-quarter revenue was \$1.09 billion, slightly better than our guidance. We managed operating expenses in line with guidance, and maintained cash balances above our optimal levels. We continued to make good progress on our three-step turnaround. Step one, restructure to reduce operating costs and improve efficiency; two, execute our 2013 product roadmap to accelerate our business and return to profitability; and, three, ultimately transform AMD to take advantage of high growth opportunities in adjacent markets where AMD's IP provides a competitive advantage.

At this point, we have largely completed our restructuring activities and we will now focus on the second step of our transformation -- executing our 2013 product roadmap and returning to profitability and positive free cash flow in the second half of 2013. Our strategy to gain share in the traditional PC space is based on winning the most important designs across each customer -- by region, price point, and form factor.

This year, we will have the broadest range of mobile processors in our history, spanning from sub-4 watts to 35 watts. We have introduced our newest A-Series Richland APU for the mainstream client market, and have secured innovative and premium design wins. In AMD's sweet spot, we have started volume shipments of Kabini in the first quarter, and have a strong portfolio of high volume entry-level design wins based on its substantial performance and battery life improvements. As part of our strategy to win new client form factors, we are ramping production of Temash in support of the ultra low-power and fanless designs. Temash beats the competition and is ideal for tablets, hybrids, and convertibles. We have a strong portfolio of customer offerings coming to market, and we expect this will spur demand in the back half of 2013, and provide us with an opportunity to grow share. Many of the new design wins are touch-enabled and will bring the full Windows 8 experience more broadly to mainstream and entry price points. Our server business revenue increased sequentially, as our high-performance Opteron 6300 series continued to ramp.

Now turning to our graphics business. In the first quarter, we saw a strong revenue growth for our desktop GPUs in the channel, and record workstation revenue. We also have a strong pipeline of design wins in the notebook discrete market, which we believe will drive mobile share growth in the second half of 2013. Our graphics business momentum is a result of our strategic decision to double down on being the gaming industry leader. As a result, desktop GPU channel sales are accelerating. We believe we have regained share, based on our industry-leading GPUs and of the Never Settle Reloaded campaign, which bundles our graphics cards with many of the industry's biggest games. The program also cements tighter connections with AMD and the leading game developers. We are leveraging our position in PC and in discrete markets, combined with our recent game console wins, as we drive to make AMD silicon the de facto standard for game developers across the globe.

Graphics IP remains critical to our success, increasingly providing differentiation across our entire product portfolio. And we remain committed to further investing in this business to extend our leadership IP. The PC market will remain an important business for AMD for years to come, with more than 300 million PCs expected to ship annually for the foreseeable future -- across a variety of form factors, the PC is far from dead. Our

industry-leading APUs and GPUs provide the opportunity to deliver share gains in this traditional AMD market. As the PC era rapidly evolves into the new cloud era, we continue to march into high-growth markets like dense server, ultra-low power client, embedded and semi-custom solutions, as we transform our business to capitalize on emerging trends reshaping the industry.

Our design approach to leverage reusable IP blocks allows us to use the same foundational technology from our PC and server offerings to quickly attack these new opportunities. As a result, we remain on track to deliver more than 20% of our revenue from semi-custom and embedded markets by the fourth quarter; and 40% to 50% of our revenue from these and other high-growth markets in the next 2 to 3 years. And a large part of the momentum this year will come from our game console wins. The game console industry is expected to ship more than 40 million game consoles in 2013. That number is expected to grow, as game consoles further evolve into broader entertainment devices that serve as home media hubs and local cloud distribution systems.

Sony's PlayStation 3 is already one of the most popular platforms for streaming online video. And Microsoft announced last year that the Xbox 360 is now used more for watching videos and listening to music than it is for playing games. Our graphics win in the Nintendo Wii U set the foundation for this growth, which we have built upon with Sony's announcement that the PlayStation 4 will feature a semi-custom AMD APU. The PS4 integrates a combination of x86 processors and advanced graphic IP, which is unique to AMD. This single-chip APU features our low-power Jaguar cores and next-generation AMD Radeon graphics. We are excited about our semi-custom pipeline, and the large opportunity for AMD to deliver semi-custom silicon with ASPs at the higher range of our client offerings.

In the embedded market, we'll introduce the industry's first quad core x86 SoC this quarter. Our low-power single-chip embedded SoC delivers more than two times the compute, and four times the graphics performance of our competitor's offerings. We are well-positioned in the embedded x86 market, which is projected to grow to more than \$7 billion by 2016.

So, in summary, we continue to make good progress in our three-step strategy designed to restructure, accelerate, and transform AMD, while returning the Company to operating profitability by the second half of 2013. We have started shipping a powerful set of new products that provides strong opportunities for share growth in the traditional PC market. And our semi-custom and embedded design wins continue to accelerate as we transform AMD for the new cloud era, and attack these high-growth markets with our differentiated IP.

We look forward to continuing this strong execution in 2013, as we enable our customers to innovate across a diversified set of markets based on our differentiated and tailored technology solutions.

And with that, I'd like to turn it over to Devinder. Devinder?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

Thank you, Rory. As Rory mentioned, AMD continues to execute on our three-phase turnaround and transform our business model to changing PC market fundamentals by diversifying our product portfolio. Phase one, reset and restructure, is largely completed, with most of our restructuring behind us. We are also on track to lower our expense base by approximately 25% by the third quarter of 2013, compared to the first quarter of 2012; and have already reduced operating expenses from \$592 million in Q1 of 2012 to \$491 million in Q1 2013.

Revenue for the first quarter of 2013 was \$1.09 billion. The 6% sequential decline was driven by a 9% decrease in the Computing Solutions segment, which was partially offset by a 3% increase in Graphic segment's revenue. Non-GAAP gross margin was 41%, an increase of 2 percentage points sequentially, and better than guided, due to a \$20 million benefit from an opportunistic emerging-market sale of certain previously reserved Llano products. Excluding this benefit, gross margin would have been flat sequentially, at 39%.

Non-GAAP operating expenses were \$491 million, in line with guidance as we continue to push towards our operating expense goal of \$450 million by the third quarter of this year. Non-GAAP operating loss was \$46 million, and non-GAAP net loss was \$94 million. Non-GAAP loss per share was \$0.13, calculated using 749 million basic shares. This loss per share includes the \$20 million benefit from sales of previously reserved products. Adjusted EBITDA was \$40 million, an increase of \$10 million from the prior quarter, due to the lower operating loss.

Now, switching to the business segments, Computing Solutions segment revenue was \$751 million, down 9% sequentially; due to lower desktop, notebook, and chipset unit shipments, primarily driven by seasonality and a weak consumer buying environment. Client product revenue declined 9%. Our server microprocessor revenue increased from the prior quarter mainly due to higher ASPs for our higher density microprocessors. Chipset revenue declined sequentially, primarily due to lower unit shipments. Computing Solutions operating loss was \$39 million, an improvement from an operating loss of \$323 million in the previous quarter. The prior quarter loss included the impact of an LCM charge of \$273 million related to the reduction of wafer purchases required in the 2012 Wafer Supply Agreement with GLOBALFOUNDRIES.

Graphics segment revenue was \$337 million, up 3% compared to the prior quarter, due to higher channel sales, game console royalty sales, and workstation graphics sales. Workstation graphics had a record quarter, and we continue to make progress in that business. Game console royalty revenue was up sequentially, driven primarily by a large milestone payment in the quarter. Graphics segment operating income was \$16 million, down from \$22 million in the prior quarter, primarily due to lower GPU sales to OEMs.

Turning to the balance sheet -- our cash, cash equivalents, and marketable securities balance, including long-term marketable securities, at the end of the quarter was \$1.2 billion, flat compared to the end of the fourth quarter of 2012. We exited the quarter above our target optimal cash level of \$1.1 billion, and well above the target minimum cash level of \$700 million. We made a \$175 million payment related to limited exclusivity to GLOBALFOUNDRIES in the first quarter, completing all of the payments related to the limited exclusivity.

In addition, we bolstered cash with net proceeds of \$164 million from the sale and leaseback of our Lone Star Campus in Austin, Texas.

In the second quarter of 2013, we will make a \$40 million cash payment to GLOBALFOUNDRIES related to the reduction in wafer purchase commitments for 2012. The remaining \$200 million balance related to this item will be paid in the first quarter of 2014. Debt as of the end of the quarter was \$2.04 billion, unchanged from the prior quarter.

Inventory was \$613 million, up \$51 million sequentially, as we prepared for new product introductions.

Now, turning to the outflow -- for the second quarter of 2013, AMD expects revenue to increase 2% sequentially, plus or minus 3%. Gross margin is expected to be approximately 39%. Quarterly operating expenses are expected to be approximately \$480 million. And inventory is expected to continue to increase sequentially ahead of new product introductions, and approach more normalized levels of \$650 million to \$700 million.

The first quarter was a good start to the year, in terms of executing to our commitments. The improvements we are making to our cost structure and liquidity management serve as a strong foundation upon which we can build throughout this year, as we refresh our product line, accelerate our execution, and return to operating profitability and positive free cash flow generation in the second half of this year.

With that, I'll turn it back to Ruth. Ruth?

Ruth Cotter - *Advanced Micro Devices, Inc. - VP of IR*

Thank you, Devinder. Operator, we'd be now happy for you to poll the audience, please, for questions.

QUESTIONS AND ANSWERS

Operator

(Operator instructions). John Pitzer, Credit Suisse.



John Pitzer - *Credit Suisse - Analyst*

Congratulations on the good quarter. Thanks for letting me ask the question. I guess the first one for Devinder -- Devinder, as you think about the OpEx guide for the June quarter and then the target for September, you are going from approximately \$490 million to \$480 million to \$450 million. Just kind of curious, the incremental \$30 million from June to September, is that actions that have already taken place, and it's just a timing issue; or more actions that need to come? If you can help me understand the drop from June to September, that would be helpful.

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

Sure. I can do that. As Rory and I said in the prepared remarks, the reset restructure is largely done. But as you probably know, there's a time lag in realizing the full benefits of restructuring. For example, some of the headcount departures are staggered. We have ongoing savings from building-related expenses that can only be realized after the employees leave. And we continue to consolidate, at various sites, to a smaller footprint in terms of space. And those savings get realized as we get out in time; and, in particular, starting in Q3 2013.

The other thing I would add is, as you probably heard from Rory's remarks, a lot of new product introductions occurred in the first half of 2013. And, therefore, with those products, there's always some costs that are associated with new product introductions that we think will go down as we get to the second half of 2013. So, really, it's time lag in terms of realizing the full benefits of restructuring; but also, as we transform the Company and accelerate into the second half of 2013, some of the reduced expenses related to the new product introductions.

John Pitzer - *Credit Suisse - Analyst*

And then, guys, as my follow-up -- just for Rory. Rory, if you think about the launch of Temash, how much of revenue do you think could come from this product category in the back half of the year? Can you give us a sense of kind of the incremental TAM that might open up for you, and kind of the incremental revenue you would expect to see?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Well, I think the overall product portfolio, John, looks pretty strong from where we are at this point. You know, Kabini in that sweet spot of the market, I think where you've seen us do well with Brazos in the past, I also think you're going to see the market begin to shift in that direction. There is no doubt ASP buying patterns will continue to move into entry and into mainstream pricing. So, I'm excited about the Kabini offering.

Then, Temash -- what I like about Temash is it's really a very credible solution in that convertible fanless space. This is an area where we need to make progress. And I believe, with this chip, which clearly beats competition -- both on computing and graphics performance -- positions us well. There is no doubt Kabini will be a much larger component, as well as Richland. But this is a very nice opportunity with this leadership part of Temash to get into tablets, and then to build it into all of the fanless form factors.

Lisa, any additional thoughts?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes. So John, I would add to that -- on Temash, we think that it does have the opportunity not just in tablets, for full Windows 8 performance tablets, but also into convertibles and hybrids. And we see a lot more of those form factors coming out from the OEMs in the second half of the year. So, I think, as Rory said, Kabini and Richland will be the larger volume plays, but Temash will be a very interesting growth play, especially with Windows 8 as we get more adoption.

John Pitzer - *Credit Suisse - Analyst*

Thanks, guys. Appreciate it.

Operator

David Wong, Wells Fargo.

David Wong - *Wells Fargo Securities - Analyst*

Thank you very much. Can you help us understand a little bit of the accounting for the game console revenues? You noted a milestone payment in the quarter just reported. What gross margin is this carried on -- at? And does the June quarter guidance assume further console-related milestone payments?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

I think -- if I can take that question, and I'll let Lisa chime in on a couple of pieces there -- but, basically, the milestone payments are predetermined based on volume of sales relative to the game console units that are sold by our customers. In particular, with one customer that we have already got engagement on in the Nintendo side, we hit that milestone. And that milestone payment came in in the Q1 2013 timeframe. And I'm not prepared to give details in terms of gross margin for that level of granularity. But suffice to say, obviously, it benefits us from a viewpoint of hitting the milestone with the volume and getting in the cash from the customer.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

I'll go first, and then pass it to Lisa. David, from the standpoint of overall strategy to diversify the portfolio, this is a very interesting opportunity for us to build off of the semi-custom solutions that we are creating. Building that base of reusable IP and then applying that IP that we've built out across our discrete graphics business and core PC business; taking it into embedded and into semi-custom around gaming, is a huge opportunity for us. And what I think what we would say is that we are very much on track to deliver over the 20% or better, in terms of the revenue by year-end 2013 from semi-custom and embedded. And we see this as a very important opportunity to diversify the portfolio.

David Wong - *Wells Fargo Securities - Analyst*

Great, thanks.

Operator

Joseph Moore, Morgan Stanley.

Joseph Moore - *Morgan Stanley - Analyst*

Yes, just following up on that. How should we think about the gross margins of the embedded opportunity as it ramps, and over the life of the consoles -- I tend to think of as being very expensive GPUs at the time of the launch; and then, sort of 3 or 4 years later, being less expensive. How should we think about the dynamics of that? I know you can't get into the specifics of any one arrangement. But just over the life of the agreements, selling silicon instead of royalties, what types of margins do you think that you would achieve over the full life?



Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

Yes, I think that's pretty complex. I think if you look out to the future, our business is in transition. Our transformation continues. Our mix of revenue is going to change pretty significantly. Even with a 20% embedded semi-custom revenue mix in Q4, and then going to the 40% to 50% from the high growth market. We are penetrating -- as you've heard us speak over the last year or so -- adjacent markets, whether it's embedded semi-custom dense servers, ultra-low power client product; and all of that has its own gross margin from a mix standpoint. So it's really hard to predict from a viewpoint of what the longer-term gross margin is. We're not providing guidance for 2013 from an overall standpoint, except for Q2 at the 39% level.

Now, as far as the longer-term interplay between the prices and how the business evolves, I'm going to let Lisa here comment on that.

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes. I would say, if you think about the entire business of the semi-custom business, it has several different business models, including IP model as well as silicon models. So I think as we get further into the year we'll talk more about the various interplays there.

Joseph Moore - *Morgan Stanley - Analyst*

Okay. But should we think of it, even this year, as being a business that has gross margins below kind of your traditional CPU business? I mean any just any kind of magnitude you can give us would be really helpful, since that's such a big part of the revenue stream.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Yes, Joseph, so where we are guiding his flat for 2Q. And we'll give further guidance as we move through the year. But we do expect to, as we said, drive to that 20% of the revenue mix by the year end. And that's where we are at this point.

Joseph Moore - *Morgan Stanley - Analyst*

Okay. Thank you very much.

Operator

Stacy Rasgon, Sanford Bernstein.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

I had a question on where -- first of all, where the gross margins ended this quarter. I'm a little confused. If you take any \$20 million inventory benefit out, they were flattish. That was in line with guidance. But you had ASPs up basically across the board -- across client, across servers, across graphics. And you had, apparently, a much higher royalty payment in the quarter as well; which, as far as I understand, falls directly through. So can you give me some feeling why gross margins were only flat? It would seem to me that they ought to have been up. Was there just something else going on, or was this just a volume effect, or what?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

I think it's a combination of factors, Stacy. You've got the different pieces from a viewpoint of -- as we talk about unit shipments and mix of revenue. There are a lot of factors that come into play from gross margin, as you probably know, from a business standpoint; at least in our backend factories



-- we still have assembly, test, mark, and pack factories where utilization coming out of the Q4-Q1 timeframe and the revenue that we have obviously affects our COGS piece of it. And that's one factor that's kind of a headwind from a gross margin standpoint.

Product mix -- we have introduced new products. Kabini is shipping in Q1, and Temash shipping in Q2. And obviously that would be a positive from a viewpoint of going with the gross margin. So you're right. We see ourselves having operated over the last few quarters in a stable gross margin situation, despite the fact that the PC market has been very dynamic, and we are projecting to the 39% gross margin in Q2.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

But if I were to follow up on that, then, so you've been operating in a stable gross margin environment. But that stable gross margins are quite a bit lower than where you were running previously. Again, you've got Temash and some other things launching, which should be gross margin accretive. But, then again, you're guiding flat for next quarter. And I guess the reason I'm asking is, I think one of the big drivers for keeping cash balances in line have to be your gross margin trajectory in the back half.

So I was just wondering if you could give us a little more color -- if not to go directly into guidance -- or at least, what are some of the things we should be thinking about into the back half of the year that can give us confidence that the gross margin trajectory can be enough to keep the cash balances up at the level where you think they can be?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

So, Stacy, from a standpoint of the second half, the overall PC market we think remains choppy, clearly in the first half; a little bit more difficult than what people had thought. We think second half is better than first half, as we said. It's probably down low- to mid-single-digits overall for the year. But if you look at our business, and you say this is a very interesting set of products that we've introduced -- from Temash, Kabini, Richland; the graphics products -- I think we're in a very good position to generate and spur demand in that second half. We are looking to build on those strong products to add share. And from our standpoint, we want to return to profitable growth in that second half.

Then you mix in the new businesses as we start to create this diversified portfolio, and the combined mix as we manage expense is a good model for us to create profitability and sustain profitability over time. So I think the net is, PC market should be better in the second half from our perspective than the first half. We have a stronger set of products in the second half. That should allow us to go after share opportunity. And then from the standpoint of graphics, same position -- strong products moving into it; and then bringing in some very interesting new products, like the PS4. This should open up a nice opportunity for us to move back to profitable growth in the second half.

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

And Stacey, to your comment to your comment on the cash -- as you can see, we've essentially finished flat quarter-on-quarter at the \$1.2 billion level of cash, above our target optimal zone of \$1.1 billion. That's well above the target minimum cash that I think is required from the Company under the current business model at about \$700 million. So, well above that. And as I've stated before, we have a lot of levers that we can pull without accessing the public markets to continue to maintain cash at the \$1.1 billion level through 2013.

Stacy Rasgon - *Sanford C. Bernstein & Company, Inc. - Analyst*

That's helpful, guys. Thank you very much.

Operator

Christopher Danelly, JPMorgan.



Christopher Danely - *JPMorgan - Analyst*

Thanks, guys. Not to beat the dead gross margin horse -- do you think that they can get back to the mid-40s? And what would be sort of the timeline of the milestones that they can get there? Are we just going to look at like gross margins in the low 40s as the gaming console starts to ramp up? And then if you could also comment on -- will you be selling down any more written-down inventory? And how much do you have left?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Chris, on the gross margin, when I say we've been very clear, we've given the [~39% gross margin guidance] (corrected by company after the call) for 2Q. That's what we're prepared to talk about today. We talked about what we like about the market in our portfolio moving forward. But, clearly our guidance around margin is we are consistently managing that the past several quarters, and it's our plan to do that again in 2Q. Devinder, do you want to comment on the second question?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

Yes, I do. Chris, was your question about the inventory write-down that we took in Q3 2012, just to confirm?

Christopher Danely - *JPMorgan - Analyst*

Yes. Are you guys going to be selling any more written-off inventory; and if so, how much?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

Yes, you know, at that time we wrote down the inventory in Q3 of 2012 to the tune of \$100 million because we could not -- we did not think we could sell the units. We had a specific opportunity that arose, as I mentioned in my prepared remarks. But we still have some of that left. And if a specific [possibility] arose, we would consider it and then take it from there.

Christopher Danely - *JPMorgan - Analyst*

Great. Thanks, guys.

Operator

Glen Yeung, Citi.

Glen Yeung - *Citi - Analyst*

I wanted to ask a question about the gaming market -- kind of on a long-term basis. I understand that these game console guys don't change the game console all that often. But if they're doing work on new functionality in game consoles, and they're also rewriting their software, do you guys think that this is a business that's more than one generation of game console long -- i.e., whether this is a new endeavor for AMD that could last tens of years types of thing?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes, Glen, this is Lisa. Let me try to give you some color there. The game console is a very, very exciting market. Its lifecycle usually lasts 5 to 7 years. And it's an opportunity to both take leading-edge hardware out there as well as continue to enhance the software. So, I do view it as an opportunity of growth over the medium-term. And certainly as we ramp new console generations, that's a direct opportunity for growth. There's a lot of conversation about where cloud gaming goes in the future, and where that sits. And that will have to play out over the next generation.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

And, Glen, from a standpoint of a strategic strategy here, and why we went after this market so strongly is -- from our perspective, I think we are building on a strong base in the PC space and the discrete graphics space. Now we go after the console. And with the work that we've done at Nintendo Wii U, and now with the Sony PS4, these game developers spend a lot of money as they move to the next generation. And with the consolidation of the game console wins that we've announced, you can see that this would allow them to develop in a more effective way, a more cost effective way. And you'll see us leverage our technology across that base from a strategic standpoint.

It lowers the partners' time-to-market; it lowers their cost of development. So it speeds that. And additionally, as they tune now to our development technology, which they're going to be able to do, it's going to perform better on our hardware and software, both from a PC from a discrete graphics, and then from a game console base. I think that sets a very nice foundation to continue to build that.

And then, Glen, you saw us double down in this space where we focused to really go after those game developers, with the Never Settle Reloaded campaign, where we went after those biggest and most important games in the industry and showed that partnership. Again, I think this is all part of a longer-term game plan to really create a differentiated experience that creates a solution for the partners, for our customers; and, ultimately, the better experience for the customer.

Glen Yeung - *Citi - Analyst*

Thanks for that, Rory. That's helpful. Maybe a follow up -- Rory, just sort of drawing on your past experience with the OEM -- or Lisa, just your experience in the market -- and thinking about what you're seeing in the second half. I know you guys aren't making heroic assumptions for PCs in the second half. But I think, Lisa, you said you think Windows 8 will adopt better. And, Rory, you did suggest second half is better than the first. Is there anything you see today that gives you any kind of confidence about that; whether that's demand from your customers already, or indications of any kind that suggests that second half 2013 better than first half, unlike what we saw last year?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Let me try, Glen, and I'll let Rory comment. No, I think it's fair to say that the PC market is still choppy, given some of the market data that came out recently. From our perspective, though, what we do see is that the OEMs are being fairly aggressive in their adoption of new form factors. I would say more so than last year, in terms of the realization of where the growth has to come, in terms of innovation. So, much more ultra-thins; much more at lower price points, as we get to 599 and below. You'll see 299, 399 price points. And that is traditionally AMD's sweet spot. That's where we design these products. So that gives us the opportunity to hopefully gain share in the second half of the year. But, certainly, we'd have to watch how that market evolves over the next couple of quarters.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Yes, and Glen, from a standpoint of if you look at this market and how it will unfold, there is no doubt Windows 8 is an important event. I know it's gotten a lot of press recently. But this -- it is clearly going to continue to build momentum. The uptake will improve as more of the form factors -- touch -- the experience becomes better known, you're going to see that activity. And based on what we are seeing from our partners, we are seeing in terms of the global design activity that we mentioned in the earlier remarks -- around the PC space there's a lot of interest in the low-power parts of Temash and Kabini, and then some of the premium form factor wins that we got with Richland.



So I think the foundation is definitely there. Win 8 will be better understood. It will be -- in terms of its adoption, and its uptake, I think that second half is generally always stronger than the first half. And that I do think that we are seeing the design activity; and it's important, Glen, from the standpoint -- we specifically target it with our products to understand the price points, the form factors, by region, by partner, so that we could go after those most effective and higher volume design wins that would yield the proper return and help us lower our overall expense.

Glen Yeung - *Citi - Analyst*

Thank you very much.

Operator

Mark Lipacis, Jefferies.

Mark Lipacis - *Jefferies & Company - Analyst*

Thanks for taking my question. Apologies if I missed this -- did you discuss how the SeaMicro business did relative to the server microprocessor business?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes, let me talk about the SeaMicro business. If we look at the SeaMicro business quarter-over-quarter, we had -- we were coming off a strong Q4. We were actually lower in Q1. This business tends to be a very deal-driven business, so it's a little bit lumpy. As we look out through 2013, we see dense server as a very good growth opportunity for us, and into the coming years as well.

Mark Lipacis - *Jefferies & Company - Analyst*

And when you talk about the semi-custom and embedded target for the fourth quarter, can you give us a sense as to how you're thinking about the relative split? Is it mostly semi-custom this year and then embedded ramps more next year?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

There's no doubt that the semi-custom business is a strong business. We're seeing very good activity there. The design win activity in embedded -- well, as said, that's going to be a \$7 billion market by 2016. We see good activity there. They tend to be a bit smaller in terms of their overall size. But when you're going to go semi-custom, those tend to be much larger. We target that pipeline. And interestingly enough, Mark, we've been working and building that semi-custom pipeline for tracking double-figure types of opportunities across industrial. In terms of home, living room, several key areas that we see semi-custom. And then you mix in the nice embedded business where I think our APUs are going to play a very important part, where you see the graphics, the gaming space, the industrial, the medical. It's a nice combination. And this is clearly where the market is going as we move into this cloud era.

Mark Lipacis - *Jefferies & Company - Analyst*

And last question -- thank you for that -- the last question from me is, the quad-core SoC that you just started shipping, have you talked about design wins for that product? Or can you talk about the target? Thank you.



Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

You're talking about, Mark, in the embedded space.

Mark Lipacis - *Jefferies & Company - Analyst*

Yes.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Yes. We're tracking right on course, as we talked about, to hit the objectives for the full year. The pipeline build has been very positive in embedded. The new product introductions like that product, which is two times competition on performance and four times on graphics, I think has really put us in a position where we can build on that. And this is around the strategy of hitting them where they're not, right? Move and take our IP where it's differentiated, where we can make a difference with the customer. And we are focused on being that partner with these customers to create the long-term solution to help them win.

I mentioned the cloud environment, the cloud era. This is a shift from this kind of proprietary controlled commercial environment, where PCs were controlled by a couple of proprietary architecture- and rule-holders, and they gathered all of the profit in a single set of pools. What I think is, the cloud era begins to break that. As data and application moved to cloud we're going to see an explosion, a tsunami of devices that are going to emerge. And our customers are looking for silicon solutions that are differentiated, that allows them to create not just a commercial solution, but a really specific differentiated solution that they can win in the market. And they're looking for a partner that's willing to work with them in a very productive, proactive, flexible way to create that solution. And isn't that kind of the AMD history, to take on next, to go against the disruption, and really focus on going forward?

Operator

Hans Mosesmann, Raymond James.

Hans Mosesmann - *Raymond James & Associates - Analyst*

Great. Thank you. Rory, a clarification. You implied or said that the PC market was going to be down mid- to high-single-digit for this year.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Low- to mid-single-digits.

Hans Mosesmann - *Raymond James & Associates - Analyst*

Okay. And then the other clarification, for the Sony game console -- the ASPs for that APU are going to be at the high end of what? Was it the high end of APU pricing, or CPU?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

What we talked about was client ASP.

Hans Mosesmann - *Raymond James & Associates - Analyst*

Okay, perfect. Now the question I have is, is the weighted position -- your lineup versus Intel as the year progresses -- should we look at it as Kabini going head-to-head with Atom-based Clover Trail-like devices from Intel, in that Temash would go after Haswell, or go head-to-head? Or is that the way to interpret your positioning?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Hans, let me perhaps help with that. So if you look at the positioning today, Kabini really goes up against Pentium, Celeron, up to the Core i3 lineup. And Temash is really, I would say, above where Clover Trail sits today, and the Atom lineup; and then it goes into the sort of the low end of clamshell. So that's the way we're setting it up. The good part about it is all of these products have started shipping. And so we're strongly in the 2C cycle, so that gives us a good position relative to time-to-market.

Hans Mosesmann - *Raymond James & Associates - Analyst*

Okay. Thank you.

Operator

Jim Covello, Goldman Sachs.

Jim Covello - *Goldman Sachs - Analyst*

Great. Thanks so much. Just following up on the PC forecast for the year. Do you have any thoughts or reconciliation for us on the difference between your view and Intel's view on the PC market, which is -- that it will be a little bit?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

You know, I think I've been, Jim, pretty consistent on that. I thought that the market was going to be choppier than some of the other competitors have felt. And I think that's playing out. I think the first half is going to be weaker than the second half. I think that's going to play out. And I do think the adoption of Win 8 will continue to improve as the year goes on. And I think there's a lot of work around improving form factors, price points; and I think the kind of product set will lend itself well to that second half. So I think it's been pretty consistent where we think the market is going. And I think that's where it's going to kind of settle in. I don't think there is -- I think that's pretty straightforward.

Jim Covello - *Goldman Sachs - Analyst*

That's helpful. I know the commentary on the cash was that the cash flow generation would return in the back half of 2013. I don't think you commented on an explicit cash burn in the second quarter of 2013.

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

Yes, I think if you do the math, you can probably come up with the numbers. But from our standpoint, as I've said previously, we have levers available. If you look at Q1 2013, I talked about the payment of GLOBALFOUNDRIES to the tune of \$175 million paid. We did a sale-leaseback transaction to almost entirely offset that, and actually a little bit more, and maintained cash flagged from last quarter. The optimal zone, or the \$1.1 billion -- and I've noticed in the no reason to believe that we couldn't exercise some of the levers needed without exercising -- accessing the capital markets and coming in the \$1.1 billion zone for Q2 of 2013.

Jim Covello - *Goldman Sachs - Analyst*

So, I'm sorry -- I don't think I understood all that. Is the idea that you have -- you'll have some operating cash burn in Q2, and then you'll pull some of the levers? Or you're not going to need to pull the levers?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

I think there will be some cash burn in the Q2 timeframe -- you know, less significant than what we have had. And I'll be able to pull some levers if needed to keep the cash in the \$1.1 billion level if we need to.

Jim Covello - *Goldman Sachs - Analyst*

Got it. Okay. I appreciate it, thank you.

Operator

Steven Eliscu, UBS.

Steven Eliscu - *UBS - Analyst*

First question around the semi-custom business; raises a potential concern on cash flow. If there isn't good sell-through on the -- your customers' game consoles, can you give us some assurance that there is some protection that you don't have to pay upfront for the wafers from your foundry partners, without at least some guarantee that you'll get paid for your deliverables in a timely fashion, and not get left holding the bag?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Yes, Steven, I think there is a historical set of data that shows the uptakes with the introduction of new game consoles. We have a very reasonable commercial relationship with all of our business partners and customers. And we believe that we'll execute within the optimal cash range throughout the 2013 year.

Steven Eliscu - *UBS - Analyst*

Yes, it's more concerning 2014 -- if, beyond the holiday season, the game consoles peter out.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

From a standpoint -- we're really talking about 2Q. And from a strategic standpoint going forward, I would really go do my modeling based on the historical trend rates of consoles. They tend to build out and accelerate over a 5- to 7-year period, and there's a curve. Our expectation will follow some resemblance to that curve.

Steven Eliscu - *UBS - Analyst*

Understood on that. I have a follow-up question for Lisa on the comments that -- on Richland and Kabini and Temash are encouraging; and also saw that Visio is using your products pretty well across their new product line. However, as you look into next year, Intel is going to be ramping its 14 nanometer processors through the year. And at that point, you're going to be, for the most part, two nodes behind. So without getting into the



details of your roadmap, can you at least help us understand, in terms of the merchant market, some of the market opportunities that you believe you will have to differentiate in PCs and tablets?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes, absolutely, Steve. I think it's fair to say that we have to be very diligent in executing our product portfolio. Our value proposition isn't necessarily based on the technology nodes and CPU performance. It's really on user experience, and how we turn our graphics and visualization advantages into something that could improve the end-user experience.

So, this year we have, as you stated, the Richland, Kabini and Temash launches, all very successful in executing in the first half of the year. We've also talked about our Kaveri APU in the second half of the year. We're on track for that. And that gives us an opportunity to bring in our heterogeneous systems architecture, which really brings the microprocessors and the graphics capability together. So we're going to continue to push that. We believe that APUs of the future, and that is where we can really get the performance. And we've gotten some validation of that with some of the game console-led discussions.

Steven Eliscu - *UBS - Analyst*

So, just one last question here, as a follow-up on that. So if you'd give us one example of something, as you look with Kaveri, that you'll be able to enable, that the competition won't be able to do. Can you give us an idea of what that would be?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes, we believe that Kaveri and the heterogeneous systems architecture will allow us to do things like natural user interface processing much more efficiently, especially in low-power environments; so, things like facial recognition, speech recognition, those types of -- sort of graphics-intensive types of applications we'll be able to do at a lower power with higher performance.

Steven Eliscu - *UBS - Analyst*

All right. Thank you.

Operator

Patrick Wang, Evercore Partners.

Michael Lucarelli - *Evercore Partners - Analyst*

It's actually Mike on for Patrick. Thanks for taking my question. Just a quick question on, what's the difference between the \$379 million payable to GLOBALFOUNDRIES and the \$240 million remaining that you talked about?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

That includes the \$240 million that we owe. We owe that in the Q1 2014 timeframe. And because there is a related party, we go ahead and disclose all the payables to GLOBALFOUNDRIES that are due to them over time. So if you look at the \$379 million within the balance sheet, ending March, there is the payables for the wafers that we have purchased over the last quarter. There is a \$200 million payable that's due in Q1 of 2014; and then there is the \$40 million that I talked about, which is going to be paid in Q2 of 2013.

Michael Lucarelli - *Evercore Partners - Analyst*

Okay, so it relates to the wafers. Got you. And then, also, the payable went down by \$75 million, but you made a payment of \$175 million. What was the delta there between the two?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

You know, the delta is really -- the 175 is the primarily delta. That was due as of the end of 2012. We paid that in the early part of 2013. So that obviously comes down. And the wafer purchases is kind of in and out. You have ongoing purchases of wafers. We paid this in payment terms, and depending on the timing of when you buy the wafers and balance sheet cutoff, you can have an increase or decrease from a payable standpoint.

Michael Lucarelli - *Evercore Partners - Analyst*

Okay, got you. And then looking at the second half, you guys talked about gaining share. What segments do you see the most opportunity in for you guys?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

Well, I think there is definitely -- from the standpoint of the product portfolio that we've introduced, I think there is definite strength in the low-power segment, in the entry -- we've talked about Temash in terms of that area. Kabini, and then of course in graphics. We have the opportunity now to go after share with a very strong portfolio. I think those would be the traditional spaces. And then of course in the embedded semi-custom, we talked about how that portion of our revenue will significantly change year-over-year, and exit the year at the 20% of total revenue.

Michael Lucarelli - *Evercore Partners - Analyst*

Okay, sounds good. And last question -- on the inventory build in the first quarter and the outlook for the second quarter, what's the composition of the inventory?

Devinder Kumar - *Advanced Micro Devices, Inc. - SVP and CFO*

It's the new product introductions, primarily, as we get ready to introduce the new products that Lisa and Rory have been talking about. We're getting ready for the launches. And you had the slight increase in inventory from Q4 to Q1. And if you recall, I did say, when we had the earnings call for the Q4 quarter, that we expected and planned for the inventory to go up as we accelerate into the second half of 2013.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

And Mike, it's important around that comment, in preparation for launches -- the work that we've done around execution and the supply chain is very important, as we reach these ramps and enter into these new markets. We've done a lot of work to improve our foundry relationships. Our foundry performance has significantly improved. And the supply chain activity has significantly improved since -- over the past 1.5 years. So, that is all around an idea to have the part; be ready; launch in volume; and be able to ramp effectively. That's something that the Company struggled with in the past. And that's something that we've worked very hard around execution to improve.

Michael Lucarelli - *Evercore Partners - Analyst*

Sounds good, guys. Thanks for taking my questions.



Ruth Cotter - *Advanced Micro Devices, Inc. - VP of IR*

Operator, we'll take two more questions from participants, please.

Operator

Yes ma'am. Srini Pajjuri, CLSA Securities.

Srini Pajjuri - *CLSA Securities - Analyst*

Thank you. I have a question and a clarification. First, the clarification -- embedded -- you said it's going to be 20% of sales exiting this year. Can you give us an idea where it is today, or in Q2?

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

It's substantially less, obviously. Our market is fundamentally changing as we move through the year. But we don't get into specifics in terms of our mix, or our segment breakdown, past compute and graphics.

Srini Pajjuri - *CLSA Securities - Analyst*

Okay, fair enough. And then Rory, maybe for you, obviously the PC market has been quite weak. But both Intel and you have reported pretty solid ASP trends even in the PC segment. I'm just trying to understand what's going on, given the weak PC. I would've expected ASPs to at least see some declines.

Rory Read - *Advanced Micro Devices, Inc. - President and CEO*

I think what you're seeing is that, from our perspective -- and I'll comment on that -- is I think you're seeing an improvement in product mix, and in terms of our product portfolio. We've worked to focus on meeting this cloud era, and in terms of the graphics around the APU that create that differentiated experience that Lisa was talking about.

From our perspective, that's really important. And we're reaching into those low-power segments. And in terms of Richland, I think we've seen some good uptake in terms of the premium wins and in terms of those interesting form factors going forward. So, it's a choppy market, Srini. There is no doubt. And we've got to continue to stay focused on the execution and on the cost side of it. But this is a good product portfolio. We've worked hard to get here, and now we are looking forward to build on that throughout the year.

Srini Pajjuri - *CLSA Securities - Analyst*

Thank you.

Operator

Thank you. We do have time for one final question.

Our final question will come from Chris Caso, Susquehanna.



Chris Caso - *Susquehanna Financial Group - Analyst*

Thank you. Thanks for squeezing me in. I wonder if you could just comment a little bit about the workstation graphics business. You had talked about that as an area of strength in the quarter. That's an area where you've had some relatively low market share in the past. Could you talk about that a little bit?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes, absolutely. If we look at our overall graphics business, we were pleased with the progress. Looking at professional graphics in particular, it is a place where historically we've had relatively low share. We have a very good product. Certainly, from a hardware standpoint, we've improved our relationships with ISVs and some of the pull-through. And so we believe that will continue to be a growth opportunity for us in graphics.

Now I'll also say, if you look at the overall graphics business, we also made some nice progress in the desktop channel, particularly in the AIB channel. And those two helped to pull the graphics revenue slightly up in the first quarter.

Chris Caso - *Susquehanna Financial Group - Analyst*

Just as a follow-up to that, what's your view with -- in terms of the graphics business, particularly discrete graphics over the longer-term -- and obviously, it requires a fairly sizable commitment in terms of R&D resource. Do you think, looking at the market going forward, is there still a return on investment for providing that R&D resource? Or do you need to be a little more selective on it, going forward?

Lisa Su - *Advanced Micro Devices, Inc. - SVP & GM, Global Business Unit*

Yes, it's very important. I mean, the graphics business is basically core to our entire portfolio. And from a discrete graphics standpoint, we think we have opportunities to gain share. I talked about the pro graphics as well as the AIB channel. The graphics IP also stretches throughout our entire client semi-custom embedded server portfolio. So it's really a core competency for the Company, and we'll continue to invest heavily in it.

Chris Caso - *Susquehanna Financial Group - Analyst*

Great. Thank you very much.

Ruth Cotter - *Advanced Micro Devices, Inc. - VP of IR*

Thank you, Operator. This now concludes our first-quarter earnings conference call. Thank you to everybody for participating.

Operator

Thank you, presenters, and thank you, participants. This does conclude today's conference. Thank you for your participation, and have a wonderful day. Attendees, you may now disconnect.



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