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AMD - Q1 2015 Advanced Micro Devices Inc Earnings Call

EVENT DATE/TIME: APRIL 16, 2015 / 9:30PM GMT

OVERVIEW:

AMD reported 1Q15 revenue of \$1.03b and net loss of \$73m or \$0.09 per share. Co. expects 2Q15 revenue to decrease 3% sequentially plus or minus 3%.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for your patience. You have joined AMD's first-quarter earnings conference call.

(Operator Instructions)

As a reminder, this conference may be recorded.

I would now like to turn the call over to your host, Ruth Cotter, the Corporate Vice President of Corporate Communications and Investor Relations. Ma'am, you may begin.

Ruth Cotter - *Advanced Micro Devices Inc. - VP of Corporate Communications & IR*

Thank you, and welcome to AMD's first-quarter conference call.

By now, you should have had the opportunity to review a copy of our earnings release, and the CFO commentary and accompanying slides. If you have not reviewed these documents, they can be found on AMD's website at ir.amd.com. Participants on today's conference call are Lisa Su, our President and Chief Executive Officer; and Devinder Kumar, our Senior Vice President and Chief Financial Officer. This is a live call, and will be replayed via webcast on AMD.com.



I would like to take this opportunity to highlight a few dates for you. AMD will host its financial analyst day on May 6th in New York, Devinder Kumar will present at the Jefferies 2015 technology media and Telecom conference on May 13th in Miami, and our second-quarter quiet time will begin as of the close of business on Friday, June 12, 2015.

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, and 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.

As a reminder, beginning in the first quarter of 2015, our non-GAAP results exclude the impact of stock-based compensation. Additionally, please note that non-GAAP financial measures referenced during this call are reconciled to their most directly comparable GAAP financial measure in the press release and CFO commentary posted on our website.

Please refer to the cautionary statements in today's earnings press release and CFO commentary for more information. And you will also find detailed discussions about our risk factors in our filings with the SEC. In particular, AMD's annual report on form 10-K for the year ended December 27, 2014.

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

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Thank you, Ruth, and good afternoon to all those listening in today.

Under the backdrop of a weaker than expected PC market, our first-quarter results demonstrate that we continue making progress in some areas of our business, but still have work to do to improve our overall financial performance.

First-quarter revenue of \$1.03 billion, decreased 17% sequentially primarily due to reduced client and graphics product sales and the seasonal decrease in semi-custom system-on-chip sales. In our computing and graphics segment, revenue decreased 20% sequentially in what was a challenging market environment, compounded by currency issues. We saw OEM demand in the quarter below seasonal expectations, as our customers actively managed inventory levels amid uncertain end-user demand.

We also reduced downstream channel inventory levels, and remain on track to return to normal inventory levels by the end of the second quarter. As result of soft PC demand and our work to rebalance our channel inventory, desktop processor and GPU revenue decreased significantly from the year ago period.

On the positive side, we did see progress in several of our strategic initiatives. Mobile APU ASPs and revenue increased from the year ago period, highlighted by increases in commercial client APU shipments and revenue from the fourth quarter, setting a record for commercial client processor sales. Our focused commercial client strategy is gaining momentum, and our investments are driving awareness and generating pull with commercial and government buyers.

We delivered record Fire Pro server unit shipments in the quarter, driven by enterprise wins and AMD professional GPUs now being offered in the world's highest volume server: HP's DL-380. We also successfully passed several key milestones in the quarter as we prepared for the introduction of our new 2015 APU and GPU products, including first revenue shipments of our Next-Generation Carrizo family of Notebook APUs in advance of system launches planned for the second quarter. Carrizo is a standout product that delivers better graphics performance than competitive offerings, as well as all-day battery life, driven by the largest generational performance-per-watt improvement we have ever delivered with our mainstream APUs.

Now, turning to our enterprise, embedded, and semi-custom segment. Revenue declined 14% sequentially, largely driven by lower game console royalties, and a seasonal decrease in semi-custom SoC console sales. Embedded processor sales were roughly flat from the year-ago period, with weaker than expected thin-client demand, offset by continued adoption of our embedded APUs across targeted market segments. Samsung

introduced a new AMD powered digital [phone -- technical difficulties] solution and both Fujitsu and GE Intelligent Platforms released new industrial computing boards powered by AMD embedded SoCs in the quarter.

At the corporate level, we continue aligning larger portions of our R&D investments to take advantage of long-term growth opportunities across our EESC segment. As we prioritize our R&D investments and simplify our Business, we made the decision in the first quarter to exit the dense server systems business as we increased investments in our server processor development. We retained the fabric technology as a part of our overall IP portfolio.

We see very strong opportunities for Next-Generation high-performance x86 and ARM processors for the enterprise data center and infrastructure markets, and we will continue to invest strongly in these areas.

Looking forward in the year, given the ongoing macroeconomic and currency uncertainties, it is hard to predict when the PC environment will normalize. We expect that the overall PC market will remain a challenge, as our OEM customers and channel partners focus on carrying lean inventories based on the uncertain market conditions. However, we are preparing for a better second half of the year, with Windows 10 and our new product offerings as catalysts for the business.

Regardless of market conditions, we are taking important steps to improve our CG business by completing our channel inventory rebalancing, introducing strong new APU and graphics products, and continuing to grow commercial client sales. I remain optimistic about our long-term opportunities, but realistic that the next level quarters will be challenging due to the market environment.

Our strategy to improve our financial performance is to focus on our strengths by continuing the investments in the technology and IP that will drive product innovation and differentiation. I look forward to talking in more detail about our long-term strategy and growth opportunities at our Financial Analyst Day in May, and I hope many of you on the call will join us for that event.

Now I would like to call over to Devinder to provide some additional color on our first-quarter financial performance. Devinder?

Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

Thank you, Lisa, and good afternoon, everyone.

Q1 was a challenging quarter, with disappointing financial results as we face the weaker than expected PC environment. We made good progress on rebalancing the channel inventory, and took actions to further streamline our focus on the opportunities for long-term growth.

Let me move to the specifics of the quarter, where I'll be referencing non-GAAP figures, except for revenue, which is on a GAAP basis. Revenue was \$1.03 billion, down 17% sequentially, driven primarily by lower sales of our client and graphics processor products and seasonally lower semi-custom sales. The year-over-year decline of 26% was driven primarily by decreased client and graphics sales.

Goes margin was 32%, down 2 percentage points from the prior quarter, primarily due to product mix and lower game console royalties in the first quarter. Operating expenses in the first quarter were \$357 million, down \$9 million from the prior quarter, due primarily to lower sales and marketing spending in line with the lower revenue in the quarter.

Operating loss was \$30 million and net loss was \$73 million, or \$0.09 per share, calculated using 777 million shares. Our first-quarter results include restructuring and other special charges amounting to \$87 million, of which \$75 million are charges related to the exiting of the dense server systems business, and another \$12 million was related to facilities activities and severance charges under the fourth quarter 2014 restructuring plan. All but \$16 million of these charges are non-cash. These charges I excluded from our segment results and I included in the all other category. They are also excluded from our first-quarter non-GAAP earnings per share calculation.



Net interest expense, taxes, and other income was \$43 million in the quarter, up from \$34 million in the prior quarter, primarily due to a nonrecurring tax credit and gain on debt repurchases in the fourth quarter. Adjusted EBITDA was \$13 million, down from \$96 million in the prior quarter, and our trailing four quarter adjusted EBITDA \$379 million.

Now turning to the business segments. Computing and graphics revenue was \$532 million, down 20% sequentially primarily due to decreased desktop and netbook revenue. Computing and graphics operating loss was \$75 million, compared to a \$56 million loss in the prior quarter, primarily due to lower desktop and notebook processor sales, partially offset by lower operating expenses.

Enterprise, embedded, and semi-custom revenue was \$498 million, down 14% from the prior quarter, primarily due to seasonally lower sales of our semi-custom SoCs, and the operating income of this segment was \$45 million, down from \$109 million in the prior quarter driven by lower semi-custom SOC revenue, lower game console royalties, and product mix. As planned, R&D investments in the embedded enterprise and semi-custom segment increased sequentially, as we invest for more growth in this segment.

Turning to the balance sheet, our cash, cash equivalents and marketable securities balances totaled \$906 million of the end of the quarter, down \$134 million from the prior quarter, primarily due to lower sales and debt interest payments in the quarter. Inventory was \$688 million, essentially flat from the prior quarter.

We entered into a fifth amendment to our wafer supply agreement with Global Foundries. Under the terms of the agreement, we expect to purchase approximately \$1 billion of wafers in 2015 on a take-or-pay basis. In the first quarter, we spent \$161 million on wafer purchases with Global Foundries.

Debt as of the end of the quarter was \$2.27 billion. Separately, we have amended and restated our \$500 million asset-backed credit facility with more favorable terms. As we have indicated in the past, this ABL affords us with additional financial flexibility as and when needed. Free cash flow in the first quarter was negative \$195 million.

Now, turning to the outlook, for the second quarter of 2015, AMD expects revenue to decrease 3% sequentially, plus or minus 3%. Non-GAAP gross margin is expected to be approximately 32%. Non-GAAP operating expenses are expected to be approximately \$355 million as we continue to invest in new products. Interest expense, taxes, and other to be approximately \$45 million, and inventories expected to be approximately up \$100 million from first quarter levels in support of second half semi-custom product revenue and the ramp of new products.

For the full-year 2015, we expect non-GAAP operating expenses to be between approximately \$340 million and \$370 million per quarter, in line with expected revenue profile, taxes of \$3 million per quarter, cash, cash equivalents, and marketable securities balances to be within a range of \$600 million to \$1 billion, capital expenditures of approximately \$100 million, and inventory to be approximately flat year-over-year.

In closing, while we are navigating some difficult industry challenges in the PC market and made progress in improving our channel inventory levels in the first quarter, we continue to invest in our product roadmaps and look forward to updating you on our long-term strategy at our upcoming Financial Analyst Day.

With that, I will turn the call back over to Ruth. Ruth?

Ruth Cotter - *Advanced Micro Devices Inc. - VP of Corporate Communications & IR*

Thank you, Devinder.

Operator, we would now be happy for you to poll the audience for questions, please.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Mark Lipacis, Jefferies.

Mark Lipacis - Jefferies LLC - Analyst

Thanks for taking my questions. The first one I guess is -- maybe it is for Lisa. The computing and graphics revenue declines have accelerated in each of the last four quarters and down 38% year-over-year.

I understand there's some channel flush going on, but based on the guidance, looks like it will be down between 30% and 40% year-over-year, so I guess I'm wondering, does that revenue trajectory create a motivation to look more aggressively at M&A or joint venture opportunities? And maybe you could just review the AMD strategy or philosophy around M&A and JV opportunities? Thank you.

Lisa Su - Advanced Micro Devices Inc. - President & CEO

Sure, Mark. So, thanks for the question. Let me start with maybe a bit of the backdrop on the computing and graphics business and what has been happening in the market. So certainly, the Q1 results are impacted by the fact that the PC market was weaker than we originally expected.

We expected when we started in January that we would have a weak first quarter due to some of our channel inventory issues. The channel business actually performed pretty close to our expectations, with the exception of some of the currency issues in Europe. On the M&C business, we did see some weaker than expected results as a result of some of the commercial hangover and the hangover from Q4.

On the broader question the computing and graphics business we have significant product, technology, and IP that serve this market very well. I think it is important for us to focus on the areas where we can differentiate and innovate.

Frankly, the portions of the business that are more commodity-like are less attractive to us, and so we have really been focusing on managing the business for improved profitability and improved differentiation. So going forward, we'll continue to do that.

You had a question about the second-quarter guidance. It is important for us to ensure that we are managing the business in a disciplined way. Given some of the uncertainties in the market, we are being more cautious on the second quarter. We do expect the second half to be better than the first half as we go forward.

Then relative to M&A and the questions there, I think we are always looking at opportunities to optimize the business, but the computing and graphics business and the enterprise, embedded, and semi-custom business share a lot of synergistic IP, particularly around the processor cores and the graphics IP technology. So we continue to believe that we can differentiate in these areas as we accelerate some of our product investments.

Mark Lipacis - Jefferies LLC - Analyst

Thank you, and a follow-up if I may. As you look into 2015, which of your businesses do you think have the best chance to post revenue growth? And as part of that, could you give us an update on the pipeline in the semi-custom business? You announced several design wins late last year. Are those still on track? Is the pipeline getting bigger on semi-custom? Thank you very much.



Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, so relative to growth and what we see, I think the second half of the year -- I would say across the board for all of our businesses -- will be stronger than the first half. Some of that is seasonal.

Some of that is opportunities that we see to improve our market share, particularly in the graphics business, as well as we ramp our semi-custom sales into the second half of the year. So, those are the key areas there.

Was there another question?

Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

The pipeline.

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

The pipeline, yes. On the semi-custom pipeline, the semi-custom wins that we announced at the end of last year are on track. We expect revenue in 2016, really starting in a second half of 2016, for those.

Relative to the overall pipeline, I think we continue to get a nice mix, particularly as we are focusing more on the enterprise and embedded space. We are seeing a nice continuum of -- I would call it standard product to custom product opportunities.

Mark Lipacis - *Jefferies LLC - Analyst*

Thank you.

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Thanks, Mark.

Operator

David Wong, Wells Fargo.

David Wong - *Wells Fargo Securities, LLC - Analyst*

Thanks very much. Lisa, can you give us some idea of what your server processor efforts are? If you were primarily to offer semi-custom capability in servers in the future, or are you making active investment in creating standard x86 and ARM server processors, as well?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, David, relative to server, we see data center -- whether it cloud or enterprise networking, to be an important growth area for us going forward. We are making significant investments in server processors, both standard as well as the IP for semi-custom opportunities. So think of it as x86, ARM, the technologies required to make competitive server products.



David Wong - Wells Fargo Securities, LLC - Analyst

Okay, great. And Devinder, have you identified any additional assets that you might be interested in selling to raise cash?

Devinder Kumar - Advanced Micro Devices Inc. - SVP & CFO

If you look at the cash situation, David, from a cash management standpoint, we have managed pretty well over the last couple of years to stay in the \$600 million to \$1 billion range, which is what we have targeted for several quarters as we have pursued our strategies from a long-term standpoint.

We did do some asset sales, if you'll recall, in the 2013 timeframe, but at this point I don't see the need to do that from an overall cash management standpoint. So, really nothing to talk about right now.

David Wong - Wells Fargo Securities, LLC - Analyst

Okay, great. Thanks very much.

Operator

Harlan Sur, JPMorgan.

Harlan Sur - JPMorgan - Analyst

Hi, good afternoon. Thanks for taking my question. As it relates to the Q2 guidance for revenues to be down about 3% sequentially, can you just help us understand directionally on the relative decline of your two segments: computing graphics versus your enterprise, embedded, and semi-custom segments?

On one hand, it seems like you'd be ramping Carrizo, and I would assume you already starting to ramp your semi-custom chipsets ahead of the console build, but yet on the other hand, still seems like you're burning through some channel inventory? So lots of moving pieces. Any help from you guys would be great.

Lisa Su - Advanced Micro Devices Inc. - President & CEO

Sure, Harlan. Our second-quarter guidance, we would expect that the semi-custom units will be up compared to the first quarter. I would say modestly up. Relative to the computing and graphics business, I think we will complete the burn off of our channel inventory in Q2, based on the current pace that we see.

And then on the ramp up of Carrizo, we will start shipping -- we started shipping actually in Q1 a small volume of units. We will increase that as we go to Q2. What we also are factoring in is, with the Windows 10 launch at the end of July, we are watching the impact of that on the back-to-school season, and expect that it might have a bit of a delay to the normal back-to-school season inventory buildup.

Harlan Sur - JPMorgan - Analyst

Great. Thanks for that.



Then question for Devinder. Given the current depressed revenue run rate, is the team expecting to burn cash again in Q2? And then just given the overall muted compute demand environment, what's sort of your view or maybe you can give us a range of your cash balance, potentially, exiting this year?

Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

If I step back and look at it, and if you look at the balance sheet even in Q1, despite the lower revenue from a year ago and also last quarter, we've [balanced] the balance sheet across the Board pretty well. If you look at the Q1 inventory, we were -- we managed to keep it flat despite the lower revenue, although [AP] is down quarter on quarter rather significantly. We've banded the cash, as I said to the earlier question, between the \$600 million to \$1 billion, and I feel we can do that in the Q2 timeframe.

And the other thing is, you might have read about the ABL Facility we have to the tune of \$500 million. In fact, we just renewed that with more favorable terms just recently and announced that today. So from my standpoint, the take away for you should be we manage cash between the \$600 million and \$1 billion target.

Harlan Sur - *JPMorgan - Analyst*

Thank you.

Operator

Ross Seymore, Deutsche Bank.

Sydney Hill - *Deutsche Bank - Analyst*

Hi, this is [Sydney Hill] for Ross, thanks for taking the question. Regarding the embedded portion, if my math is right, I think your first -- in Q1 and Q2, your year-over-year growth are both negative. Are you still expecting this business to grow for the full-year? I guess it depends on -- the gaming side of things, as well?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, I think your question is probably about the enterprise, embedded, and semi-custom segment and the segment revenue. So, relative Q1 year-over-year, I think we've mentioned that the semi-custom SOC sales were down a bit, as well as embedded was relatively flat.

As we go full year, we haven't given full-year guidance at the segment level yet, so I think what we've said before, which I still believe is true, is that the semi custom units will likely be up. Year-over-year. The ASPs are known, we just have to see on the second half of year develops relative to overall demand.

Sydney Hill - *Deutsche Bank - Analyst*

Okay. Then my follow-up question is related to gross margin. I think you are planning to build about \$100 million of inventory for semi-custom revenue in the back half.

Does that mean all else equal, because semi-custom has lower margins, that your overall gross margin will come down in the back half? Or maybe just a broader way of asking the same question: how should we think about the gross margin trajectory for the remainder of the year, and what are some of the puts and takes to think about?



Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

I think first of all, let's take Q2 first of all, from a guidance standpoint and our guiding flat to Q1. I know market environment, especially on the PC side, is uncertain.

Product mix would be the main driver for the gross margin, and obviously as Lisa remarked earlier, we are very focused on disciplined execution of the business, and we will continue to do that. In particular, correcting the channel inventory situation that we are trying to get done with in the Q2 timeframe.

Longer-term, if you ask me from an overall standpoint, obviously our goal is to grow on an accretive basis. The margin opportunities that embedded and server and pro-graphics affords us, as well as a richer mix of business in the client PC space as we introduce our new products that we've talked about. The other thing I would encourage you to do is, we are going to lay out more details on our longer-term standpoint at our Financial Analyst Day that's coming up on May 6th, and that's where we will share more details in terms of the longer-term model.

Sydney Hill - *Deutsche Bank - Analyst*

Okay, thank you.

Operator

Stacy Rasgon, Bernstein.

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

Hi, guys, thanks for taking my questions. First, I had a question on OpEx. You have a range of \$340 million to \$370 million, and that's supposed to be based on the revenue outlook. So given your revenue trajectory, I'm surprised that you are not taking OpEx down more toward the lower end of that range.

Can you tell us, I guess, what products you are investing in, and where would revenues actually need to go before you felt the need to take OpEx down to the lower range?

Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

If you go back and look at the OpEx, and in particular we were just talking about the enterprise, embedded, and semi-custom area. If you look at the OpEx first of all, from a Q4 to Q1 standpoint, the OpEx is down. Sales and marketing, specifically, is down about 9% quarter on quarter.

R&D is up slightly, and I can tell you that the R&D without getting to the specifics has been targeted to those areas where we feel afford us the best longer-term opportunities from a growth standpoint, and the best opportunities from an improving the financial performance standpoint. And obviously we are, in a very targeted manner, investing in the enterprise, embedded, and semi-custom area, which is where we have had very good traction in 2014. Design wins continue in 2015 to revenue, as Lisa talked about earlier, in 2016, and in pursuit of those businesses we will go ahead and invest in those areas.

As far as you're question about modulating the expenses, in the areas that are more related I guess to the business, CG for example, the revenues down I have said many times that we will modulate our expenses in line with the revenue profile and even with the sales and marketing decrease, quarter on quarter is very much in line with that profile.

However, the one thing I think we have to be mindful about is about is the R&D investments. We do want to fund for the future in terms of investing in the product roadmap, so that we do not in the short-term take action that [sacrifices] the long-term future both for the Company and the product roadmap, and that's why I think your observation is right. With the revenue down 3% on a guided basis, expenses are flat but primarily targeted towards the R&D areas.

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

Got it. That's helpful. For my follow-up, I had a question I guess on the trajectory of the console revenue. I have got to say, I was a little surprised at the level of guidance and even in the current quarter, your foundry supplier for consoles had consumer revenues in Q1 up quite a bit. We don't seem to be seeing that in your revenue guide.

I know last year, we had a bit of a stronger console profile in the first half, and then it was flattish I think a little lower than what expectations had been in the second half. It sounds like now maybe you are expecting that profile to reverse, and you are seeing a stronger console presence in the second half than the first half. Can you give us some color based on those drivers, on how you see that trajectory moving through the year?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, Stacy. We do expect that -- it is hard to call console seasonality, as each year is somewhat different. So last year, if you remember the first half was coming off of a very strong holiday season where there was still unsatisfied demand. As we go from the second half 2014 into the first half 2015, I think the demand is more normalized.

There is an expectation that the second half of 2015 will be stronger in terms of units, and that's what we see from our customers right now. We are very in tune with them in terms of their forecast, and so that's what we see at the moment.

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

But why would it be stronger? Don't they need to build in front of the holidays?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

They do, but the peak quarter for semi-custom is always going to be the third quarter, because that's when they will build ahead of holidays. What we saw in the first half of 2014 was more I would say demand that was not satisfied from the previous holiday.

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

Got it. It's fair to say that pricing will be down year-over-year, correct?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

It is fair to say there are some ASP decline, that's correct.

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

Got it. Thank you, guys.



Operator

Christopher Rolland, FBR Capital Markets.

Christopher Rolland - FBR & Co. - Analyst

Hey, guys, thanks for the question. So, the move to Win10 might be important for you guys -- even more important than your competitor, given the consumer PC profile there.

Also your competitor has been really backend loading sales for the year, particularly due to some channel inventory dynamics, where we clear the decks to make room for Win10, and then we have that initial channel build wrap to support Win10 when it comes out. I guess first of all, do you guys see the same channel inventory effects, and then also do you see that same backend loading of the year as well for PC?

Lisa Su - Advanced Micro Devices Inc. - President & CEO

Sure, so Chris. What I would say is we do see some of the same dynamics particularly in the near term as we are going from the first quarter into the second quarter. I do think OEMs are being somewhat cautious of any inventory build now ahead of Win10.

As you go forward into the second half of the year, I think first of all, I think we are all optimistic that Win10 can be a catalyst and a driver for the market. However to what extent will depend on some of the macro conditions that we talked about. I think the currency issues in Europe have to clean up some, I think the Win 10 launch has to be strong, and then we will see how the second half shapes up.

Christopher Rolland - FBR & Co. - Analyst

Okay, great. Your inventory was flat in 1Q. That's probably a quarter where that should have been down. I imagine some of that was maybe to support some upcoming product launches. Then of course, you guided inventories up another \$100 million next quarter, but you left your 2015 inventory guidance unchanged. So what has to happen there? What are your expectations there to aggressively ramp down inventory into the back half of the year?

Devinder Kumar - Advanced Micro Devices Inc. - SVP & CFO

Good question. I think two parts to it. If you go back and look at our inventory profile, even in 2014 in particular, with the significant revenue we are getting in the semi-custom space, the semi-custom customers that we have, we have to supply the product to them essentially a quarter ahead of when they build their parts.

And therefore they are seasonally high sales up in Q4, we build the product and supply it in Q3, but we have to get the wafer supply and inventory up in Q2, and fundamentally the increase from Q1 to Q2 is to support the semi-custom ramp, as well as what we said earlier about the second half being stronger than the first half. And obviously we need to be prepared for that, so I think from an overall standpoint, despite the challenges we talked about in the PC market, managing inventory flat in Q1 was good.

And we followed the same profile like we did in 2014, which is our plan. You should see inventory go up during the year to support the ramp of the semi-custom and then supplying the product, and then at the end of the year, being able to manage down to flat inventory year on year.

Christopher Rolland - FBR & Co. - Analyst

Great, thanks, Devinder.

Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

You're welcome.

Operator

Hans Mosesmann, Raymond James.

Hans Mosesmann - *Raymond James & Associates, Inc. - Analyst*

Thanks. Lisa, if you can clarify. In the second half of this year, you expect roughly seasonal trends in the PC centric parts of your business due to Win 10?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes. So Hans, I think we would see the second half would be roughly seasonal. I think we would have to see how it fully develops over time.

Hans Mosesmann - *Raymond James & Associates, Inc. - Analyst*

Okay. Just wanted to get that, because your competitor is suggesting that it will be stronger than seasonal. The follow-on question if I may, can you give us a timeline in terms of Seattle and ARM server ramps, and when it becomes relevant or meaningful in terms of sales?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, Hans a lot about to that other question. I would love or it to be greater than seasonal, but I think it is very hard to call at this point in the year.

So relative to Seattle, Seattle we continued to sample, and customers are continuing to develop both systems and software. Relative to the production ramp or volume shipments, I think we will see that in the second half of this year.

Hans Mosesmann - *Raymond James & Associates, Inc. - Analyst*

Thank you.

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Thanks, Hans.

Operator

Vivek Arya, Bank of America.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thank you for taking my question. Lisa, just a quick clarification. I think you mentioned the semi-custom wins are second -- on the revenue, second-half 2016. I just wanted to make sure that wasn't a change from what you had before? And then I had a question.

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, Vivek, it is actually not a change from what we had before, it is probably more specificity. We probably before said 2016, and now it is second-half 2016. It is just a little bit more detail.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Got it. And then do you think PC gaming is a growing or declining market? And you mentioned that you expect some share gains in the back half? What specifically do you think will help you regain that market share?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, so thanks for the question, Vivek. That I do believe PC gaming and gaming in general is a growth opportunity in the market, and growth opportunity for AMD. So, as I look forward, we are launching Carrizo on the APU side, and we are also launching some graphics products in a second half of this year.

So I think from the standpoint of being able to capture more of the market and increase more to where our normal shares are in graphics, I think that something that we believe we can make progress towards.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Just one last one for Devinder. Devinder, did you say Q2 cash burn would be better or worse than Q1? And is \$1 billion the right level for the wafer supply agreement, given your sales outlook in the first half?

Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

Yes, first of all, I didn't give a cash guidance for Q2, but what I said specifically is we manage within the \$600 million to \$1 billion balance, the range we have provided, the target minimum was at the optimal.

On the WSA, the \$1 billion that we talked about and signed in the WSA that we just confirmed with Global Foundries. There is a mix of revenue there, just as a reminder. And I think you know this, but the large portion of the amount that we have is a good mix of product across PC, graphics, and semi-custom, as opposed to if you go back in two years ago. So I would say it is very much in line with our expectations of how the market is going to evolve this year in particular in the semi-custom space.

Vivek Arya - *BofA Merrill Lynch - Analyst*

Thank you, guys. Good luck.

Operator

Sanjay Chaurasia, Nomura.

Sanjay Chaurasia - Nomura - Analyst

Devinder, first question on the semi-custom operating income. It seems like it was significantly below the average of the last four, five quarters. I was just wondering if you could highlight where the compression came from and if that goes away in the coming quarters?

Devinder Kumar - Advanced Micro Devices Inc. - SVP & CFO

Yes, I think if you look at it from an overall standpoint, at the segment level semi-custom in part of the enterprise, embedded, and semi-custom segment. The impact to the operating income in that was really three factors.

If you look at the game console royalties based on the Q4 to the Q1 transition, lower game console royalties in Q1. The product mix obviously had a play in that, and then the other thing that we referenced earlier and Lisa talked about, higher R&D spending, where we are targeting more spending in that area to pursue more opportunities, and all of those three factors combined caused the lower operating income percentage for the quarter.

Sanjay Chaurasia - Nomura - Analyst

And as a follow-up, if I may. Lisa, you made comments on x86 based sever opportunity, and as you put out in your roadmap, I was just wondering if you guys still want to compete the way you had competed with Intel earlier, or are you narrowing your opportunities? Any color would be appreciated.

Lisa Su - Advanced Micro Devices Inc. - President & CEO

Yes, so Sanjay, I think when we look across our portfolio and our priorities, we are very focused on the places where we can differentiate and innovate. Relative to x86 opportunities, clearly the x86 server market is very large market. It is one where we have historically been successful, so I do believe that it is an area that we can grow over the medium term. And when we talk about additional investments in enterprise, embedded, and semi-custom, many of those investments are directed at the server and the embedded markets.

Ruth Cotter - Advanced Micro Devices Inc. - VP of Corporate Communications & IR

Operator, we will take the next question please.

Operator

John Pitzer, Credit Suisse.

John Pitzer - Credit Suisse - Analyst

Good afternoon guys. Thanks for letting me ask a question. Devinder, just a follow up on the WSA. Do you have a forecast of what payments to Global Foundries might look like in the June quarter? And just help me understand, to get from the run rate in Q1 to kind of a full-year guide of \$1 billion, how should we think about the linearity of those payments?

Devinder Kumar - Advanced Micro Devices Inc. - SVP & CFO

Yes, I think Q2 amount I won't get in the quarterly profile, but if you listen to the comments we were making in terms of some of the actions we are taking in Q1 and Q2, the first half of the year relative to the PC market, and then you listen about the semi-custom profile first half to the second half, while the purchases in the first quarter are at the \$161 million level, you can expect that it is going to follow the trajectory of the business.



Second half being stronger than the first half, the semi-custom ramp happening in the second half. A significant portion of the \$1 billion is semi-custom products, and that's exactly how it goes throughout the year.

John Pitzer - *Credit Suisse - Analyst*

That's helpful, and then Lisa, as my follow-up -- granted that it is difficult enough to look out 90 days and have an accurate forecast given the volatility in PCs, let alone the full year, but if you just grow seasonally in the back half of the year, your PC business is going to be down at probably greater than 20% year-over-year for the full year.

So I would love to get your sense of what you think the market for PCs is doing this year? Is the gap between that and seasonality shared loss? Or more importantly, when do you think you're going to be positioning these products to actually gain back some share in the market?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

John, good question. For clarification, the comment about the market was really one on it is hard to call that the market will be substantially better in the second half than the first half. I think it will be better, due to seasonality.

Relative to our business, our business certainly in the first quarter and in the second quarter, is not really relative to seasonality. I would say we had some inventory issues that I want to correct as soon as possible, so that we get our new product stream fairly clean into the market. So as we go into the second half of the year, we would like to see some regain of share in both the desktop and the notebook business. I talked about Carrizo being a strong product for us, I talked about some of our graphics launches that we will talk about later this quarter.

From our standpoint, I would say the first half of the year, we had some -- let's call it some of our issues that we were correcting in terms of the channel, and then a weaker than expected market environment. In the second half of the year, I think we would like to see our products take a strong position, as well as hopefully the market get stronger as well.

John Pitzer - *Credit Suisse - Analyst*

Perfect, thanks, Lisa. Appreciate it.

Operator

Matt Ramsey, Canaccord.

Matt Ramsey - *Canaccord Genuity - Analyst*

Yes, thank you very much for taking my question. I think expanding on some of the questions that have been asked on the PC business, declines in share, declines in market, declines of the inventory and the channel. It looks like for -- give or take for the first half of the year, your computing and graphics business is going to be down maybe 30%, 40% from the first-half over first-half perspective from last year.

Maybe, Lisa, can you help us at all figure out how much of that is due to burning through stuff in channel, versus the market being down, versus share losses? Any kind of ballpark figures would be really helpful.

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Let's see, Matt, let me think about the best way to answer that question.



So let's say it this way, I think we gave you a couple of pointers when we talked about the first quarter, year-over-year. We actually saw mobile revenue go up relative to first-quarter 2014. Desktop revenue was down. I think from that standpoint, there was a good piece of that desktop reduction that was channel inventory correction, and then some of that was the desktop market being weak.

When we look and you talk about market share, you're often talking about unit share, and from the standpoint of unit share, we have selectively decided that there some pieces of business that we are not going to service because they are very unprofitable. That is some of the share decline that you have seen. Relative speaking, we have kept ASPs pretty solid, and we would be looking for forward-looking to really improve our mix going forward in getting both the revenue as well as the ASP and mix up.

I know that's not exactly answering your question, but what I'm trying to give you is the context for is -- the desktop market probably to a larger hit, first-half to first-half, just given what's happening in the market in desktops as well as our channel inventory problem. I think the notebook business, we have made some progress. That we have a very strong product coming out in Carrizo.

Matt Ramsey - *Canaccord Genuity - Analyst*

It really do appreciate the color, and I think that's helpful. As a follow-up, I wanted to jump into a little industry perspective in the server market. A couple questions, there.

One, obviously the decision to exit the SeaMicro business from a platform perspective. Maybe you could talk a little bit, Lisa, about what's changed there and led to that decision.

Second, it seems a lot of the questions that I hear are focused on the server opportunity, as maybe we all think about the server market, but I think what's interesting is also how the line between server and enterprise networking is blurring bit through NSD and SDNs. Maybe talk about some of the opportunities in end-markets where it's not a traditional AMD versus Intel fight, but more new markets that are server teams that are opening up as an opportunity for your business? Thanks.

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Absolutely. Let's talk about investments and priorities.

I've been on the job about six months, and I've really been looking at the overall portfolio; where do we think we can make measurable gains that are sustainable and what the priorities should be? It is clear that we have a lot of technology, but we need to focus our resources on the places that I would say are stickier pieces of business.

So relative to the SeaMicro business, that was a strategic decision to really exit the systems business, and if you think about SeaMicro, it was really specializing in micro servers. Micro servers have not developed at the pace that we might have thought a couple of years ago. From the way we look at the market, our core competency is really in processors, and being able to service that business through either standard or semi-custom products is the way we will address the server business.

Going forward I think the longer-term question, when you look at our IP, whether you talk about our processor IP or some of our packaging and system IP know how, I think additional servers is one place; certainly dense server, cloud, enterprise, are important, and then as you state, the blur between traditional enterprise and networking is there.

I think we are repositioning our portfolio. Repositioning the portfolio always takes a bit of time, and so we are working through that repositioning, but we will give more color on some of the target markets at the financial Analyst Day and certainly Forest Norrod, who has recently joined us, has a lot of thoughts on where we think we can win in these spaces.



Matt Ramsey - *Canaccord Genuity - Analyst*

Thank you very much, look forward to hearing more in a couple weeks.

Ruth Cotter - *Advanced Micro Devices Inc. - VP of Corporate Communications & IR*

Operator, we will take two more questions, please.

Operator

Yes, ma'am.

Chris Danely of Citigroup.

Chris Danely - *Citigroup - Analyst*

Things for letting me ask a question, guys. Lisa, you talked about currency impact in Europe. Can you just elaborate on that? And maybe when you think it is going to stop or stabilize or go away?

Lisa Su - *Advanced Micro Devices Inc. - President & CEO*

Yes, so Chris we did see the effect of currency in Europe. I guess the way I would describe it is Eastern Europe, just very low demand, and we did see that a very clearly -- Western Europe, actually the demand is okay, but what the currency issues have done is, they've resulted in our partners and customers carrying fairly lean inventories, just given all of the fluctuation.

I think it is hard to say when it is going to stabilize, but we certainly have clear signals as we look at sellthrough on a weekly basis, and all those things.

Chris Danely - *Citigroup - Analyst*

Great and for my follow-up, I guess just a clarification on the WSA, so you said it today in this year. What was it last year? I think it was pretty close to \$900 million or \$1 billion? And I guess I thought that most of that or a good portion of that was CPUs, and given that CPUs are going to be down substantially this year, can you just help me with the map as to how \$1 billion works for this year revenue, when it is going to be down substantially -- (multiple speakers)

Devinder Kumar - *Advanced Micro Devices Inc. - SVP & CFO*

-- asking, but 2014 the WSA I think was about \$1.1 billion, so it is slightly lower this year than last year, at the \$1 billion level, and the billion dollars of mix of revenue semi-custom graphics and PC.

I talked earlier about purchasing \$161 million in Q1, and expected the purchases will be in line with our business growth in a second half of the year, and obviously you heard the comment about inventory being up \$100 million quarter on quarter from Q1 to Q2. Is our anticipation in support of the new product introductions, as well as the semi-custom ramp in the back half of the year.

Chris Danely - *Citigroup - Analyst*

Got it. Okay, thanks, Devinder.

Operator

Ian Ing, MKM Partners.

Ian Ing - MKM Partners - Analyst

Yes, thanks for fitting me in. Just some clarification on the SeaMicro exit. For the June quarter, are there any sequential revenue or gross margin impacts from the exit? And SeaMicro, is it fully written down at this point, or are there any assets or IP, that you perhaps can monetize? I know at the time Freedom Fabric looked kind of interesting on interconnect side.

Devinder Kumar - Advanced Micro Devices Inc. - SVP & CFO

I think two-part question. If you look at our GAAP charges that we took in Q1, \$87 million, the bulk of that is related to this SeaMicro systems business exit, \$75 million. The bulk of that is non-cash intangible assets, and obviously there's severance related activities and expenses that are cash.

As far as fabric is concerned, the IP is still available for us as needed. But that's the way I would leave it.

Ian Ing - MKM Partners - Analyst

And impact on June quarter?

Devinder Kumar - Advanced Micro Devices Inc. - SVP & CFO

It is already counted for. We went ahead and booked the expenses when we made the decision to exit the systems business, and those expenses are already accounted for in the charges we took in Q1, so there will be no impact on the -- residual impact on the Q2 financials through the guidance that we have provided.

Ian Ing - MKM Partners - Analyst

Okay, understand. Then lastly currency challenges in the regions. Do you have any sort of natural cost hedging with overseas manufacturing? Whether it is front-end wafer supply or backend packaging and test, that can help out?

Devinder Kumar - Advanced Micro Devices Inc. - SVP & CFO

Yes, we have operations in [on-port] on the engineering side, as well as on the manufacturing side in China and Malaysia; engineers in India, China, Canada, and we do the typical hedging programs in terms of forecasted expenses on an OpEx basis and go ahead and hedge that. And have been largely successful in mitigating the impact of the currency overall to the P&L, from an OpEx standpoint.

Ian Ing - MKM Partners - Analyst

Okay, thanks, Devinder.

Ruth Cotter - Advanced Micro Devices Inc. - VP of Corporate Communications & IR

Great, Operator, that concludes today's earnings conference call.

If you could close the call and we would like to thank everybody for participating.

Operator

Thank you, ma'am, and thank you, ladies and gentlemen, for your participation. That does conclude AMD's first-quarter earnings conference call.

You may disconnect your lines at this time. Have a great day.

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