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AMD - Q3 2016 Advanced Micro Devices Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 revenues of \$1.3b and non-GAAP net income of \$27m or \$0.03 per share. Expects 2016 revenue to grow approx. 6% and 4Q16 revenue to decrease 18% sequentially, plus or minus 3%.



CORPORATE PARTICIPANTS

Ruth Cotter *Advanced Micro Devices, Inc. - Chief Human Resources Officer and SVP of Corporate Communications and IR*

Lisa Su *Advanced Micro Devices, Inc. - President and CEO*

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

CONFERENCE CALL PARTICIPANTS

Matt Ramsay *Canaccord Genuity - Analyst*

Mark Lipacis *Jefferies LLC - Analyst*

John Pitzer *Credit Suisse - Analyst*

David Wong *Wells Fargo Securities, LLC - Analyst*

Chris Hemmelgarn *Barclays Capital - Analyst*

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PRESENTATION

Operator

Greetings and welcome to the Advanced Micro Devices third-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Ruth Cotter, Chief Human Resources Officer, for Advanced Micro Devices. Ms. Cotter, you may begin.

Ruth Cotter - *Advanced Micro Devices, Inc. - Chief Human Resources Officer and SVP of Corporate Communications and IR*

Thank you, and welcome to AMD's third-quarter conference call. By now, you should have had the opportunity to review a copy of our earnings release and the CFO commentary and 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, Chief Financial Officer, and Treasurer. This is a live call, and will be replayed via webcast on AMD.com.

I'd like to highlight a few dates for you this afternoon. Lisa Su will present at the Credit Suisse PMT conference on November 30 in Arizona. I will present at the NASDAQ investor program on November 30 in the UK. Devinder Kumar will present at the Barclays Global Technology Media and Telecommunications Conference in December in San Francisco. And our fourth quarter quiet time will begin at the close of business on Friday, December 16, 2016.

Before we begin, let me remind everyone that third-quarter 2016 was a 14-week quarter, and we expect to record our extra week in the fourth quarter of 2016. 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.

Additionally, please note that we will be referring to non-GAAP figures during the call, except for revenue, which is on a GAAP basis. The non-GAAP financial measures referenced 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.

Please refer to the cautionary statements in today's earnings press release and CFO commentary for more information. You'll also find detailed discussions about our risk factors and our filings with the SEC, and in particular, AMD's quarterly report on Form 10-Q for the quarter ended June 25, 2016. With that, I would like to hand the call over to Lisa. Lisa?

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Thank you, Ruth, and good afternoon to all those listening in today. Our strong third-quarter results highlight the progress we have made across AMD this past year, as we improved our financial performance by delivering great products. Third-quarter revenue of \$1.3 billion increased 27% sequentially and 23% from the year-ago period, driven by upside demand for our graphics products, and record semi custom sales.

In addition to the significant revenue growth, we also achieved several financial and operational milestones in the quarter. We strengthened our balance sheet and improved our P&L through a series of capital markets transactions that reprofiled and reduced our debt. We also signed a strategic amendment to our Wafer Supply Agreement with GLOBALFOUNDRIES that provides sourcing flexibility and financial predictability. Most importantly, we delivered non-GAAP net income in the quarter, based on strong execution of our product road map, and growing momentum across our business.

Looking at our Computing and Graphics segment, we had solid growth in the quarter. Revenue increased 9% sequentially, and 11% from the year-ago period, driven by improved sales of mobile APUs and discrete GPUs. Mobile processor revenue and unit shipments increased for the fourth straight quarter, as 7th-generation APU shipments continued ramping, highlighted by the launch of our new PRO Series APUs earlier this month with HP.

Customer and partner excitement for our Zen-based desktop product, Summit Ridge, is growing as we successfully passed several key engineering and design win milestones in the quarter. We provided our first competitive performance preview of Summit Ridge in the quarter, and believe we will have a very competitive offering for the \$4 billion high performance desktop processor market. We are working closely with our infrastructure partners and customers, in preparation for the launch in early 2017.

In graphics, we had a very strong quarter, with discrete GPU revenue and unit shipments growing by double-digit percentages sequentially and year-over-year. The launch of our expanded family of Polaris desktop GPUs, and our first full quarter of RX 480 sales drove our highest quarterly channel GPU revenue and ASP since early 2014. Radeon RX GPUs now account for more than 50% of our channel GPU revenue.

Polaris GPUs continued to gain traction based on their leadership performance in VR and on the rapidly expanding number of software titles that feature the latest generation of APIs, like DirectX 12 and Vulkan. Our progress in the quarter was punctuated by Oculus, announcing a limited edition Oculus-ready PC, powered by an AMD FX processor, and Radeon RX 470 GPU that brings the cost of entry for a VR-ready system down to \$500 for the first time. This is a meaningful milestone for consumers, and I am excited that AMD is enabling the ecosystem, and driving broader adoption of VR, by making premium experiences available at such an attractive price point.

We also delivered our fourth straight quarter of sequential revenue growth for our professional graphics products. In addition to solid workstation sales growth, we expanded our presence in the server GPU market, as HP announced availability of multiple Radeon options across their traditional and blade server offerings. And just last week, we announced the collaboration with Alibaba Cloud, China's largest cloud provider, to deploy Radeon PRO server GPUs across their datacenters to expand the scale and services of their global cloud offering.

We now have material server GPU engagement with multiple cloud datacenter providers, demonstrating that our strategy to grow our presence in this profitable market by delivering superior performance with Radeon PRO hardware, in conjunction with industry-standard programming tools and APIs, is beginning to pay off. Now, turning to our enterprise embedded and semi-custom segment.

Revenue increased 41% sequentially, and 31% from the year-ago period, driven by record semi-custom sales, which included the ramp of three new FinFET-based products powering the Xbox One S, updated PlayStation 4, and our new design win in the Sony PlayStation 4 Pro. We are on track to grow semi-custom unit shipments and revenue for the third straight year, demonstrating our leadership in high-performance gaming technologies for the very successful game console market. We expect fourth-quarter revenue to be down seasonally, as we transition from our annual semi custom sales peak in the third quarter.

Our embedded product sales grew sequentially, as our newer design wins reached production. In server, our Zen-based high-performance processor remains on track for introduction in the first half of 2017. We successfully passed several silicon and platform technical milestones in the quarter, and have secured multiple new design wins across OEM, enterprise, and cloud providers.

In closing, as I complete my second year as CEO of AMD, I am pleased with the solid progress we have made across the Company on multiple operational, product, and financial fronts. We are executing our long-term strategy, and a set of near term priorities that I believe provide AMD with significant opportunities over the next 18 to 24 months, to drive top line revenue growth, operating margin expansion, and free cash flow generation.

We have strengthened the core of the Company, by clearly defining the markets where we have technology and expertise to win; bringing a laser focus to our product execution around our graphics and microprocessor road map; creating deeper, more lasting relationships with strategic customers; monetizing our assets and valuable IP with two joint ventures in China; and reengineering our balance sheet to increase our cash balance and reduce debt. I want to thank the thousands of AMDers whose determination this past year has allowed us to put in place the financial and operational foundation to drive growth and profitability.

In 2017, with Zen and Vega, we are focused on delivering our strongest product portfolio in over a decade, capable of unlocking multiple growth pillars for our business across the data center, gaming, and high performance graphics and PC markets. I am proud of what we have accomplished, and I believe that the best is yet to come. Now, I'd like to turn the call over to Devinder, to provide some additional color on our third-quarter financial performance.

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

Thank you, Lisa, and a very good afternoon to everyone. In the third quarter, we achieved another milestone in our progress as we return to non-GAAP net income profitability. The third-quarter financial performance was driven by strong demand for our semi custom SoCs, higher graphics revenue, and positive free cash flow.

We executed a series of capital markets transactions that have significantly improved our balance sheet, and turned that profile, and will reduce interest expense beginning in Q4. We also finalized a long-term strategic Wafer Supply Agreement with GLOBALFOUNDRIES.

Third-quarter revenue was \$1.3 billion, up 27% sequentially, driven by higher sales of our record semi custom SoCs and higher graphics processor sales. The year-over-year revenue increased 23%, driven by higher sales of our semi custom SoCs, client mobile processors, and graphics processors.

Non-GAAP gross margin was 31%, flat from the prior quarter, driven by a richer mix of PC and graphics products, offsetting lower margin semi custom product. Non-GAAP operating expenses were \$353 million, up \$11 million from the prior quarter, due to increased R&D investment. We recognized \$24 million of net licensing gains, associated with our server JV with THATI. Non-GAAP operating income was \$20 million this quarter, up \$67 million from the prior quarter.

Third-quarter other net expense was \$63 million, mostly consisting of a \$61 million loss related to debt retirement. The equity loss in the ATMP JV was \$5 million based on our 15% JV ownership stake. Non-GAAP net income was \$27 million, with earnings per share of \$0.03.

Non-GAAP EPS was calculated using 865 million diluted shares of common stock, which includes 12 million shares associated with the equity offering that closed late in the third quarter. Included in our GAAP operating loss and GAAP net loss is a \$340 million charge associated with our fixed amendment to the WSA with GLOBALFOUNDRIES. Adjusted EBITDA was \$103 million, compared to \$36 million in the prior quarter.

Now, turning to the business segments. Computing and Graphics revenue was \$472 million, up 9% from the prior quarter, and up 11% year-over-year, primarily due to increased sales of GPUs and client mobile APUs. Computing and Graphics segment operating loss was \$66 million, compared to \$81 million the prior quarter, primarily due to higher revenue.

Enterprise embedded and semi custom revenue was \$835 million, up 41% from the prior quarter, and 31% higher year-over-year, driven by higher semi custom SoC sales. Operating income of this segment was \$136 million, up from \$84 million in the prior quarter, primarily driven by higher revenue.

Turning to the balance sheet, our cash and cash equivalents totaled \$1.3 billion at the end of the quarter, up \$301 million from the end of the prior quarter, including \$274 million remaining from the proceeds of our capital market transaction. Excluding this amount, the cash was \$984 million, as compared to \$957 million last quarter. Free cash flow was a positive \$20 million in the third quarter.

Inventory was \$772 million, up \$29 million or 4% from the end of the prior quarter, in support of holiday season GPU and semi custom product sales expectations in the first part of the fourth quarter. Total wafer purchases from GLOBALFOUNDRIES in third quarter were \$168 million, and we continue to expect overall wafer purchases of approximately \$650 million in 2016, including \$155 million purchased in early 2016, as part of the fixed amendment to the WSA.

Debt as of the end of the quarter was \$1.6 billion, down from the prior quarter, due to our significant debt reduction effort. During the third quarter, we raised approximately \$1.4 billion in cash, as a result of issuing \$690 million of common stock, which includes the exercise of an underwriter's option to purchase 15% or \$90 million of additional common stock, and the issuance of \$700 million in 2 1/8% convertible notes due in 2026. We used the majority of these funds to redeem outstanding term debt through cash tender offers, and we paid off the outstanding ABL balance of \$226 million.

In addition, early in the fourth quarter, another \$105 million of convertible notes were issued as part of the exercise of an underwriter's option, bringing the total principal amount of the 2026 convertible notes to \$805 million. We also redeemed the remaining principal debt balance of \$208 million of the 2020 senior note, which was our most expensive debt. This debt has now been fully paid off.

The debt reductions and issuance of the new convertible notes due 2026 that occur in the third quarter and early in the fourth quarter will result in approximately \$55 million of annualized cash interest savings, beginning in the fourth quarter. Please refer to today's CFO written commentary for further details of the capital markets transactions and debt on the balance sheet. Free cash flow in the third quarter was a positive \$20 million, compared to a negative \$106 million in the second quarter of 2016, primarily due to increased revenue, improvement in working capital, and a reduction in capital expenditures.

Now turning to our fourth quarter 2016 outlook, a 14 fiscal week quarter, as it has an extra week. We expect revenue to decrease 18% sequentially, plus or minus 3%, primarily driven by a seasonal decline in our semi custom business, and an improvement in our CG business. Revenue at the midpoint of guidance would be up 12% year-over-year. Non-GAAP gross margin to be approximately 32%.

Non-GAAP operating expenses to be approximately \$350 million. IP monetization licensing gain to be approximately \$25 million. To maintain non-GAAP operating profitability, non-GAAP interest expense, taxes and other to be approximately \$32 million. Cash and cash equivalents to be up, in line with our guidance of ending 2016 with positive free cash flow, excluding cash from capital market transactions, and the net proceeds from the ATMP JV.

Inventory to be down to approximately \$660 million. Basic share count to be approximately 930 million, including 115 million shares related to the third-quarter equity issuance. And we now expect full-year revenue growth to be up approximately 6% from 2015, based on the midpoint of fourth quarter revenue guidance.

In closing, we are very pleased with the progress we have made in the third quarter. With focused execution we continue to build a solid financial foundation for the Company. In just the last three months alone, we achieved non-GAAP net income profitability, amended the WSA with

GLOBALFOUNDRIES across multiple years, and deleveraged and derisked the balance sheet with our capital markets transaction, such that over the next five years, there is less than \$200 million of term debt due.

We look forward to continued execution, and further improving our financial performance. With that, I'll turn it back to Ruth. Ruth?

Ruth Cotter - *Advanced Micro Devices, Inc. - Chief Human Resources Officer and SVP of Corporate Communications and IR*

Thank you, Devinder. Operator, we would be pleased to poll the audience for questions, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question today is coming from Matt Ramsay from Canaccord Genuity. Please proceed with your question.

Matt Ramsay - *Canaccord Genuity - Analyst*

Thank you very much. Good afternoon. Obviously a lot has gone on in the last quarter. I figured I would ask a couple things about Zen, since that's been one of the things that's most topical, in my conversations with investors.

Lisa, you talked about in your prepared remarks, there are multiple OEM engagements and design wins for desktop, and also the same on server. Maybe you could do a little bit to expand upon those? The timing of launch of each, and in particular in the server market, the focus, whether that be enterprise, or whether that be cloud-based. Thank you.

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Absolutely, Matt. Thanks for your question, and as you said, it's been a very busy quarter for us. As it relates to Zen, we are on track to launch in the first half of the year, for both our desktops and our servers. The desktop launch will go first, and it is on track for the first quarter, and then the server launch will go in the second quarter.

We've had a wide amount of sampling that's gone on in the third quarter. We have multiple customers on both the PC side, as well as the server side, who have working hardware now in their labs. They're bringing up their platforms and software, and we're very pleased with how smoothly it's coming up, actually.

So you asked specifically about the server side. Our focus on servers is really across the OEM business, including enterprise, as well as the cloud data centers. And I think the key for us is we're getting a lot of interest from our partners, and we continue to work with them to bring up their systems. But I think we are optimistic about where we are in the Zen bring-up, and the Zen launch cycle.

Matt Ramsay - *Canaccord Genuity - Analyst*

Thank you for that. That's helpful. I guess as a follow-up there, in the server market, I think obviously your GPU primary competitor has had some very stellar traction with server acceleration around GPUs, and you highlighted in the prepared remarks some wins and engagements that you had on Polaris, and I assume on Vega for server acceleration.

Maybe you could expand on that commentary a bit, what you're investing there, how the GPUOpen, or the OpenCL Environment is developing relative to the CUDA environment in server acceleration, and just what proportion of your GPU business could be driven by that server opportunity in the long term? Any commentary there would be great. Thanks.

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Yes. So let's talk overall about our graphics business. So when you look at our graphics business, certainly we're very pleased with the progress that we've made on the consumer side, with Polaris. But we've also mentioned that we've made good progress on the professional graphics side, including both workstations, as well as server GPUs.

I think the market is certainly very receptive to growth in the server GPU area. I was just at the Alibaba Cloud computing conference last week, where we announced our collaboration with them. They're actually using parts that are pre-Polaris and pre-Vega. We were demoing a GPU-based cloud server based on some of our FirePro technology, using hardware-based virtualization.

I think the main feedback that we've gotten from them, as well as multiple other cloud engagements, is the hardware looks very good. We're working with them on the overall infrastructure and software to bring that up, and we believe that the products are very competitive in this market. And the market is nice because it's certainly margin accretive, to the consumer side of the business.

So we do expect as we bring out Vega in the first half of 2017, that will certainly strengthen the product portfolio. But there's a lot of interest in the cloud space around what we're doing with Radeon PRO and on the server GPU side.

Matt Ramsay - *Canaccord Genuity - Analyst*

Thank you very much. I'll get back in queue. Appreciate it.

Operator

Thank you. Our next question today is coming from Ross Seymore from Deutsche Bank. Please proceed with your question.

(Operator Instructions)

Ruth Cotter - *Advanced Micro Devices, Inc. - Chief Human Resources Officer and SVP of Corporate Communications and IR*

We can go to the next caller, operator. Thank you.

Operator

Certainly. Our next question is coming from Mark Lipacis from Jefferies. Please proceed with your question.

Mark Lipacis - *Jefferies LLC - Analyst*

I had two questions. First one, on the Alibaba deal, so this is not a new set of products you're developing, it's products you already have. And can you talk about, to the extent this is a cloud services offering versus deep learning applications, that they might be doing with your products? And I guess when I think about the architecture, I normally think about having an X86 processor sitting next to the GPU. I was wondering is it logical to assume that Zen is the natural X86 pairing with your GPUs in the Ali deployments?



Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Sure, Mark. So again, I think on the Alibaba deployment, it is the beginning of what we expect to be a long-term collaboration. So the work today is being done on a pre-Polaris base, but we do expect that will upgrade as we go forward.

I think the key is, there are many, many applications, but what we're starting from is a GPU base cloud server application, so in virtualized environments, you can imagine cloud gaming or remote workstation-type environments which need a lot of graphics horsepower, as well as virtual desktop environments. And I think as we go forward, certainly, we view the opportunity to expand that into a broader set of workloads, as well as obviously on the CPU side as well. We think the cloud is a very important market for us to focus on, on both the GPU and the CPU side, and we're ramping up our efforts there.

Mark Lipacis - *Jefferies LLC - Analyst*

Great. A follow-up if I may. Last night Tesla announced that it was using NVIDIA for their self-driving car, but on the conference call Elon Musk, I think the expression he used, was that it was a tight decision between NVIDIA and AMD, which suggests that you're further along in solutions for deep learning and neural networking than most, including myself, thought.

And so I was wondering, can you talk about your efforts in deep learning and artificial intelligence, how big is that business now? Do you have anything in that business now? And how do you grow that, going forward? Thank you.

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Sure, Mark. So look, there is a lot of interest in the deep learning space overall, and certainly our GPUs are very applicable to that space. So when we look at competitiveness and all that stuff, we think we can be very competitive there.

We will be talking more about our strategy in the coming quarters, so maybe let me refer to that, Mark. But I think suffice it to say, I think we looked at GPUs as overall secular growth, whether you're talking about consumer, professional workstations, server GPUs, or any of this machine learning area. So we're going to continue to invest and lean in, in those areas.

Mark Lipacis - *Jefferies LLC - Analyst*

Thank you.

Operator

Thank you. Our next question today is coming from John Pitzer from Credit Suisse. Please proceed with your question.

John Pitzer - *Credit Suisse - Analyst*

Lisa, Devinder, nice job on the quarter. I guess, Devinder first. Just going to the December quarter guidance, you're characterizing it as seasonal.

I know the trappings of talking about normal seasonal, because there's so much variance around it, but it does seem like in prior quarters, where you had a 14th week, that extra week actually did help revenue a little bit. I'm just kind of curious within the context of the December quarter guidance, how you're thinking about that extra week, both on the revenue line and on expenses.

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

I think if you look at a 14-week quarter, I think, John, you're right, it depends upon many factors. Our 14-week quarter is in the Q4 time frame, which is this quarter we are in. On the revenue side, I would say looking at it overall, there's not much of an impact, as the extra week falls during the holiday season, when a large portion of our operations and our customers are in shutdown mode. There is an impact on the expense side, but that's already contemplated within the guidance of OpEx that I gave, the \$350 million due to the extra week.

John Pitzer - *Credit Suisse - Analyst*

That's helpful. And then Lisa, a little bit longer term. Over the last several quarters, you've been somewhat forced to try to manage profitability levels to that breakeven line, given the lack of revenue growth.

But now that you're on this path of more sustainable revenue growth, I'm just curious as you think about R&D specifically, how should we think about your desire to want to invest in higher rates, as revenue begins to grow from these levels? Because clearly, as Mark talked about on the last question, you've got a lot of potential new areas and opportunities to go after. Can you give us a sense as to what -- to what degree you think you've been under-investing in R&D and how we should think about R&D investments over the next several quarters, as revenue growth resumes?

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Absolutely, John. I think it's fair to say that we've been very prudent in how we've invested overall. If you look at our operating expenses, 2016 to 2015, although we've been relatively flat overall, we've actually increased R&D, relative to other elements of the P&L.

But as we see revenue growth and as we've seen progress over the last couple of quarters, I think you've also seen us increase our R&D spend. I think there are several areas that we see as very large opportunities, and we talked about some of the graphics areas in the previous question with Mark. I also think in the data center, there's a large opportunity for us on the CPU side, as Zen fully comes to market.

So I think we have an opportunity to invest a bit more in R&D as our revenue grows, but we're still going to be very prudent with how we do that. I think the key metric there in terms of being net income profitable this quarter, ensuring that we get free cash flow positive from operations for the full year, those are all important metrics for us, and we're going to continue to manage very diligently.

John Pitzer - *Credit Suisse - Analyst*

That's helpful. Thank you. Congratulations.

Operator

Thank you. Our next question today is coming from David Wong from Wells Fargo. Please proceed with your question.

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

Do you expect GPU sales will grow sequentially in the December quarter, and what about computing revenues?

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Yes, so David, I think we would expect overall that the CG business or the Computing and Graphics business will grow in Q4. The EESC business will be down. And then within the Computing and Graphics business, I would expect growth on both the graphics, as well as the computing side.

David Wong - Wells Fargo Securities, LLC - Analyst

Great. And do you have any new semi custom wins you can tell us about, or at least give us some idea of what the momentum is in the pipeline?

Lisa Su - Advanced Micro Devices, Inc. - President and CEO

Yes, I think on the semi custom side, David, I will say that we previously announced three, and that's the number that we'll talk about today. Two of them are now known, and they're both in the game console area, one is outside of game console. I will say that we have some very good active discussions on future products and applications, and we'll update more as we get further along.

David Wong - Wells Fargo Securities, LLC - Analyst

Great. Thanks.

Lisa Su - Advanced Micro Devices, Inc. - President and CEO

Thanks, David.

Operator

Thank you. Our next question is coming from Blayne Curtis from Barclays. Please proceed with your question.

Chris Hemmelgarn - Barclays Capital - Analyst

This is Chris Hemmelgarn on for Blaine. With Summit Ridge launching in Q1 of 2017, how would you expect the channel to ramp that? Do you see it ramping pretty fully in the first couple quarters of the year, or are you looking for more normal PC seasonality?

Lisa Su - Advanced Micro Devices, Inc. - President and CEO

I would expect that there will be a relatively good initial demand for Summit Ridge, that may be not quite at the seasonal patterns. From where we see, Summit Ridge is playing in a space in the high end desktop, that we currently aren't offering a product. So we believe we'll be competitive certainly with Core I5 as well as Core I7, and we will be launching in those areas.

Chris Hemmelgarn - Barclays Capital - Analyst

Thanks very much. Then looking at the GPU side of things, you saw some pretty nice share gains in the first half of this year with the legacy portfolio. Any metrics you can give to help frame how the business did in the first full quarter with Polaris? And any further color you can provide on how you see the share situation progressing into the year-end.

Lisa Su - Advanced Micro Devices, Inc. - President and CEO

We're very happy with how Polaris ramped in Q3. The customer demand across all geographies was very strong. Q3 was primarily a channel-based quarter. With our board partners, and as some of you noted, in the early part of Q3, we actually had some supply constraints, given the customer demand. We did catch up towards the end of the quarter.

So very pleased with how that's ramped. I think it's a very competitive market. We've leaned into VR, and we've leaned into our work with CX12 and I think you can see in some of the benchmarks that we're doing very well there. As we go into Q4, in addition to the channel partners continuing to ramp, you should expect some OEMs launching in Q4 more broadly. And so Polaris is off to a very strong start.

Chris Hemmelgarn - *Barclays Capital - Analyst*

Thanks very much, Lisa, and congrats on the strong quarter.

Operator

Thank you. Our next question is coming from Stacy Rasgon from Bernstein Research. Please proceed with your question.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

I first wanted to ask about the second sourcing ability embedded in the new Wafer Supply Agreement. So you've said that you're going to be doing some second sourcing, starting in 2017. I wonder, did that push to actually seek out that supply diversification come from you, or was it from specific requests from your customers? And given that, how do you make the decision on which products to manufacture at GLOBALFOUNDRIES versus manufacture somewhere else?

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

Sure, Stacy. Let me start with that. I think, relative to our second sourcing or our supply sourcing flexibility, I think we make it on a product-by-product basis, based on where we are in the business. So we will have multiple products in 14-nanometer and 16-nanometer that will be sourced across foundries, and similarly when we talked about the Wafer Supply Agreement, we mentioned 7-nanometer as being a key target node for that.

Relative to how we make the decisions, I think it's a combination of factors. It includes the complexity of the product. It includes the timing, customers, all kinds of things. So I think that's part of our product planning process.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got it. But did the customers themselves have a hand in driving you to make that push to second source?

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

I think that's one element, but frankly, I think what's more important to me is, I need to commit a strong, five-year product road map to the customers, and so we want to make sure that we have all the flexibility to ensure nothing happens. I'll give you just a little bit of context, Stacy, because I think you know our business well.

In this past six months, we've ramped five new FinFET products. It's the fastest transition we have ever made in a process node, and it's gone really, really well. And I think what's helped us with that is the fact that we've had two sources ramping at the same time.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got it. For my follow-up, I just want to get some clarification on the timing of the Summit Ridge and Zen launches. You said Summit Ridge launches obviously in Q1 2017. You had said before that you were going to be shipping at least some product in Q4 of this year. Is that still true? And around the server launch in Q2, does that mean the volume is actually in Q3?



Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

So I think our expectation is, we may ship some production samples in Q4, but the volume launch for desktop will be in Q1, and that's consistent with everything that we've planned into the business. And as it relates to server, I think it's a little early to tell. I think we'll go through our process, and our customers' processes, and we'll have more color on that, as we get into next year.

Stacy Rasgon - *Sanford C. Bernstein & Co. - Analyst*

Got it. Thank you.

Operator

Thank you. Our next question today is coming from Ambrish Srivastava from BMO Capital Markets. Please proceed with your question.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

In your prepared remarks, you mentioned semi custom's decline and computing graphics to be up. Implies you'll have a pretty rich mix for Q4. Why is GM guided up only 1% given the really strong mix for 4Q?

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

If you look at it from an overall standpoint, let's talk about Q2 to Q3, first of all. Q2 to Q3, we had a significant ramp in the semi custom space, which led to significant revenue in the EESC side, and we were able to manage the margin flat quarter on quarter, which we are pleased with. Going to Q4, essentially with the Computing and Graphics business, that's what Lisa said ramping, and then EESC business, in particular semi custom coming down. The gross margin is up a percentage point, primarily due to the mix in revenue between the two segments.

Ambrish Srivastava - *BMO Capital Markets - Analyst*

Okay. And for a follow-up, a question on the cash balance. Looked like you're guiding cash to be up in 4Q, and looks like you have some excess cash after the transactions you've done in the quarter, and looks like you might be up over your \$1 billion target balance. How do you plan on using the excess cash, or where would you reinvest that cash?

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

I think right now, as you observe, it's through the end of Q3 we did have some remaining net proceeds from the capital market transactions. After completing what we did in the early part of Q4, we have about \$162 million of remaining net proceeds.

What we plan to do with it, I think from a long-term strategy, that hasn't changed. Our plan is to continue to delever the balance sheet, reduce debt towards our longer-term targets getting to the net debt cash neutral that I talked about previously, and getting the leverage ratio down to about 2 times from a longer term standpoint.

Ruth Cotter - *Advanced Micro Devices, Inc. - Chief Human Resources Officer and SVP of Corporate Communications and IR*

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



Operator

Certainly. Our next question today is coming from Joe Moore from Morgan Stanley. Please proceed with your question.

Joe Moore - Morgan Stanley - Analyst

Lisa, you talked about a \$4 billion performance desktop opportunity. What's your thinking in terms of what you can eventually attain of that, just how are you thinking about your potential for market share? And can you give us some sense for, when you have a chip like this, that you have enthusiasm about, how quickly it can ramp into that segment? Thank you.

Lisa Su - Advanced Micro Devices, Inc. - President and CEO

Yes. So I think if you look at our PC market share, as it's published by Mercury, we're talking about somewhere around 10%, plus or minus. I think we view that historically we've been higher than that in the PC market, and certainly the desktop market, especially the desktop channel market. We're fairly well-known by that customer set.

So we're enthusiastic about Summit. We think the performance is right on the mark with what we wanted to achieve. And we're hopeful that as we launch into the first quarter, that there will be a good, solid ramp in that business.

Joe Moore - Morgan Stanley - Analyst

Okay. Great. And then, how are you thinking about as you think about bringing that chip to market, when will you make it available for third party benchmarks and sort of get a broader marketing program beyond the launch you've done?

Lisa Su - Advanced Micro Devices, Inc. - President and CEO

I would expect certainly there are a lot of confidential benchmarks at the moment, but in terms of third party benchmarks, you would expect that in the first quarter.

Joe Moore - Morgan Stanley - Analyst

Thank you very much.

Operator

Thank you. Our final question today is coming from Chris Rolland from Susquehanna Financial Group. Please proceed with your question.

Chris Rolland - Susquehanna Financial Group - Analyst

Congrats on a great quarter, and nice to see it all coming together. We don't have September sell-through data yet. It's hard to predict holiday season, what it's going to look like for consoles. Perhaps the past two quarters' growth in EESC might be outpacing expectations for consoles.

So my question is, first of all, is that right? Is there something that's helping your guy's units here, like initial channel stocking for the PS4 Slim or the PS4 Pro? And how should we think about the size of the benefit that you're going to get from initial channel stocking there?

Lisa Su - *Advanced Micro Devices, Inc. - President and CEO*

So, Chris, I think the game console shouldn't be really looked at on a quarterly level, when you're looking at sell-in and sell-out. It's so different from the other markets. I would say on an annual basis, everything trues up. The thought process is, in Q2 and Q3, there is a bit of build ahead as the customers are really building for the holiday season. And the customers do so much of their business in the last six weeks of the year. That's when all of the inventory is drained.

My view is that if you look on an annual basis, the game console business is doing quite well. We expect units to be up. We expect revenue for the business to be up for us, and the quarterly transitions are less important. It's more, we want to ensure that we're meeting our customers' build cycles, so that they get to build everything that they want, and get it into their channels. But from my standpoint, I think it's a very well-managed system.

Chris Rolland - *Susquehanna Financial Group - Analyst*

Great. Congrats on a great quarter.

Ruth Cotter - *Advanced Micro Devices, Inc. - Chief Human Resources Officer and SVP of Corporate Communications and IR*

Operator, that concludes today's call. If you could wrap it up, please, that would be great.

Operator

Certainly. That does conclude today's teleconference. You may disconnect your line at this time, and have a wonderful day. We do thank you for your participation today.

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