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Intel Corp. Rating Lowered To 'A' On Operating Challenges And Deteriorating Financial Position; Outlook Negative

- Santa Clara, Calif.-based semiconductor manufacturer Intel Corp. reported fourth-quarter 2022 financial results and provided first-quarter 2023 financial guidance well short of our expectations due to continued weak PC demand, inventory corrections across client and server end markets, and company-specific execution issues.
- We expect weak operating results in 2023 across its client computing, data center and AI, and network and edge business segments, resulting in about $7 billion to $8 billion negative free operating cash flow (FOCF) before dividends and S&P Global Ratings'-adjusted debt leverage weakening to the low- to mid-2x area by the end of 2023.
- Therefore, we are lowering our ratings on Intel, including our issuer credit rating, to 'A' from 'A+'.
- Our short-term commercial paper rating remains A-1.
- The negative outlook reflects our expectation that Intel's adjusted debt leverage will remain near 2x (excluding the proposed acquisition of Tower Semiconductor) by the end of 2024 as working capital uses, significant capital spending, and dividend payments will keep net debt elevated. We expect industry trends will improve following the cyclical trough of client and server CPU end markets in 2023 and the company's cost saving initiatives of $8 billion to $10 billion over three years should help with its FOCF trajectory.

SAN FRANCISCO (S&P Global Ratings) Feb. 1, 2023—S&P Global Ratings today took the above rating actions.

Near-term negative macroeconomic trends and more severe than anticipated PC market slump are adding to already challenged business prospects. We expect weaker-than-anticipated PC and server chip demand in 2023 and continued market share loss to competitor Advanced Micro Devices (AMD), especially in the server end market, which could persist through 2024. This is reflected in the revision of

our business risk profile score to satisfactory from strong. Given Intel's significant capital spending requirements, which we believe are necessary to regain its technology and product leadership, material working capital uses, and about $6.1 billion of annual dividend payment, its net debt balance will increase markedly over the next two years. Its S&P Global Ratings-adjusted debt-to-EBITDA ratio will rise to the low- to mid-2x area by the end of 2023, breaching our prior downgrade trigger of 1.5x.
The PC market is experiencing weakness that started in the second quarter of 2022. Intel's overall revenue was down 28% on a year-over-year basis in the fourth quarter of 2022, with its two largest business segments, client computing group and data center and AI group, down 36% and 33%, respectively. The company's first-quarter 2023 guidance indicates that further deterioration is likely citing a "generational" inventory correction. We expect overall revenue to fall by about 40% year over year, while factory underload charges and ongoing product investments have a significant impact on its gross margins.

We expect Intel's revenue will decline in the mid-teens percentage in 2023 to about $53 billion. We base this on Intel's high exposure to the weak PC market, which we believe will experience high-single-digit unit shipment decline in 2023, slower enterprise and data center spending given macroeconomic uncertainty, a cautious IT spending outlook, and company-specific challenges including continued market share losses and poor product execution. This follows a 20% revenue decline in 2022. It is reasonable to assume demand should improve in the second half of 2023 given the length and the depth of the current CPU cyclical downturn, but macroeconomic challenges such as the rising interest rate, geopolitical tensions in Europe, and the recent China reopening following its COVID-zero policy add uncertainty

We believe Intel's profitability and cash flows will remain strained over the next two years, negative $7 billion to $8 billion in 2023 and negative $2 billion to $4 billion in 2024, while Intel continues to invest aggressively. Even under a successful technology transition, we expect profitability to be below historical norms given the increasingly competitive environment and the expansion into the foundry business that will have margins much lower than Intel's corporate average given its small scale to start.

Competitive industry dynamics and Intel's aggressive roadmap continue to challenge our view of its long-term business prospects. We continue to view Intel's product roadmap as aggressive given its track record of technology missteps. Intel remains committed to delivering five process nodes in four years, achieving process performance parity in 2024 and regaining its leadership position by 2025 with Intel 18A. The company recently launched its fourth-generation Intel Xeon processor, Sapphire Rapids, in January 2023, which was originally scheduled for a fall 2021 release. Product launch delays have allowed AMD to gain significant market share over the past two years, threatening Intel's long-established dominant market position in the x86 client and server CPU markets.

Execution will be key as it pursues its integrated design manufacturing (IDM) 2.0 strategy. We believe there is high execution risk to re-establish process leadership, especially given similar investments by industry peers such as TSMC and Samsung Electronics Co. Ltd. and its main competitor AMD

outsourcing chip production to foundry leaders TSMC and Samsung.
Intel's heavy capital spending, which we estimate will be about $15 billion to $17 billion in 2023 and $19 billion to $20 billion in 2024, net of government support and various subsidies, will weigh heavily on its profitability over next several years. We believe the company's "Smart Capital Strategy", which includes pursuing government incentives, customer commitments, and financial partner co-investment to help offset 20%-30% of capital spending, will help smooth the FOCF trajectory. While government incentives, such as those anticipated from the U.S. CHIPs and Science Act, would clearly be positive in reducing capital intensity on fab and R&D investments, customer commitments and financial partner co-investments merely shift the timing of cash flows rather than lower the risk of capital investments.

Intel's balance sheet will weaken further in 2023 and recovery will take time. We expect Intel's adjusted debt-to-EBITDA ratio to reach the low- to mid-2x by the end of 2023, up from 1.1x currently, before improving slightly to about 2x (excluding proposed acquisition of Tower Semiconductor) by the end of 2024. Although we forecast adjusted EBITDA margin will rise about 140 basis points to 31.3% in 2023 as the company executes to its $3 billion targeted cost savings, EBITDA will still be lower than 2022 as a result of our expectation for a mid-teens percentage revenue decline in 2023, with its two largest business segments client computing group and data center and AI both down about 20% year-over-year. More importantly, we forecast net debt to increase significantly in 2023 with about $8 billion negative FOCF and an estimated $2.7 billion S&P Global Ratings debt-like adjustment for Brookfield's portion of the Arizona fab joint venture capital contribution for construction funding to date.

Intel remains committed to its dividends, which we view as sizeable at roughly $6.1 billion per year, and this will further stress its liquidity position. We would view a reduction or elimination of dividend to be a modest credit positive but do not expect that to significantly alter our view of the company's financial risk profile. Should Intel pursue a sizable acquisition over the next one to two years (larger than the pending acquisition of Tower Semiconductor Ltd. for $5.4 billion), its financial risk profile could be further pressured. At the same time, we note Intel has been disciplined about pruning noncore assets (sale of the McAfee Corp. and NAND businesses) and further monetization of its Mobileye ownership could generate sizable cash proceeds to offset the cash outflow, which we view favorably in our assessment of the company's capital structure. We forecast Intel will generate a FOCF deficit over the next year or two, inconsistent with peers rated in the 'A' category. If we don't see a clear path to substantial cash flow improvement over next several years, this will also pressure ratings.

Intel has a joint venture with the infrastructure affiliate of Brookfield Asset Management, which will provide Intel with capital for manufacturing buildouts. Under the terms of the agreement, the companies will jointly invest up to $30 billion in Intel's previously announced manufacturing expansion at its Ocotillo campus in Chandler, Arizona, with Intel funding 51% and Brookfield funding 49% of the total project costs. Intel will retain majority ownership and operating control of the two new leading-edge chip factories in Chandler, which will support long-term demand for Intel's products and provide capacity for Intel Foundry Services customers. Brookfield, as a 49% owner, will be entitled to the proportional earnings and cash flows of the joint venture. We view Brookfield as a financial partner, while Intel bears the construction and wafer production risks. Our analytical treatment would include recording the amount approximating Brookfield's capital contribution to the joint venture, estimated at up to $15 billion, as debt at Intel prior to construction completion. Intel will likely incur the bulk of the construction spending in 2025 and 2026 when most of the semiconductor tools are purchased and installed. The debt adjustment will be lowered to the extent cash distributions to Brookfield are made by the joint venture, which we expect to begin in 2026 once production starts. Correspondingly, we plan to consolidate the full joint-venture-generated EBITDA in Intel's operating results, similar to the company's accounting treatment. We do not believe the analytical treatment of this joint venture structure will have a meaningful impact on our view of Intel's credit profile from an alternative treatment in which we do not consolidate the Brookfield debt but remove the cash distribution from Intel's earnings.

The negative outlook reflects our expectation that Intel's adjusted debt leverage will remain near 2x (excluding the proposed acquisition of Tower Semiconductor) by the end of 2024 as working capital uses, significant capital spending, and dividend payments will keep net debt elevated. Intel's FOCF trajectory should be aided by an improvement in industry trends following the cyclical trough of client and server CPU end markets in 2023 and the company's cost saving initiatives of $8 billion to $10 billion over three years.

We would consider a lower rating if:

- Business recovery is weaker than that reflected in our 2024 base case scenario which could be the result of a weakening competitive position as indicated by delays in its technology roadmap, worse-than-expected market share losses in either client or server end markets, or lack of progress in its foundry strategy;
- We expect FOCF to remain weak with limited prospects for significant improvements; or
- We expect adjusted leverage will remain above the 2x area beyond 2024 due to either lower profitability or more aggressive financial policies, including debt-funded acquisitions.

We would consider an outlook revision to stable if Intel can demonstrate its improved operating performance through successfully executing its process node technology roadmap and market share gains leading to sustained profitability enhancement and debt leverage below 2x.

ESG Credit Indicators: E-2, S-2, G-1

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

European Endorsement Status

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