FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Intel to 'A-'/'F2' from 'A+'/'F1'; Outlook Negative

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Fitch Ratings - Chicago - 02 Feb 2023: Fitch Ratings has downgraded Intel Corp.'s Long-Term Issuer Default Rating (IDR) and senior unsecured ratings to 'A-' from 'A+', and Short-Term IDR and Commercial Paper Ratings to 'F2' from 'F1'. The Rating Outlook on Intel's Long-Term IDR is Negative.

The ratings and Outlook reflect Fitch's view that structurally higher investment intensity as Intel seeks to regain technology leadership and build out its foundry services business amidst weak demand conditions and market share losses, will result in significant intermediate-term negative FCF. Offsets to capital investments, including financial partnerships and government incentives, are likely insufficient to support cash needs over this horizon, requiring incremental debt funding and pressuring credit metrics. Meanwhile, execution risk is considerable, given that Intel is cutting costs while investing to out-innovate competitors over the next three-to-five years.

KEY RATING DRIVERS

Negative Intermediate-Term FCF: Fitch expects FCF will be negative over the 2023-2025 period as Intel completes its investment super-cycle aimed at regaining manufacturing technology leadership and building out its foundry services business. Meanwhile, revenue and profitability will be down considerably in 2023, driven by record excess inventory following robust PC and server demand surrounding the pandemic-related policies. Profit margins will fall to record low levels in the near term before rebounding in 2024, with the resumption of positive revenue growth and flow-through of benefits from Intel's $3 billion cost savings initiatives.

Fitch expects cash balances to remain high in the $20 billion-$30 billion range; however, Fitch expects the company to fund cash burn with a combination of contributions from financial partners, such as its JV with Brookfield Capital, government subsidies and tax benefits and, likely, incremental debt issuance. Fitch expects the potential for higher debt levels and lower profitability in 2023 will drive credit metric deterioration and position the company in the low 'A' rating category. Fitch forecasts EBITDA leverage, estimated at 2.1x exiting 2022, will remain in the 2.0x-3.0x range over the 2023-2025 period, while CFO-Capex/Total Debt (adjusted for JV-minority partner contributions) will be negative to minimal.

Structurally Higher Investment Intensity: Fitch believes higher investment intensity is structural rather than temporary given Intel's commitment to regaining process technology leadership and building out IFS. Intel's success, which would enable it to stem or reverse market share losses and gain a meaningful foothold in the $100 billion foundry addressable market, rather than moderate spending levels, will determine the company's ability to remain in the 'A' rating category.

Fitch is cautious on guidance for longer-term capital spending normalization, given that elevated spending levels are in line with technology leaders. Intel's expanded outsourcing of advanced products manufacturing to TSMC adds flexibility to the pace of investments and hedges against technology roadmap missteps. However, Fitch believes dynamics related to the development of a domestic semiconductor supply chain, including significant co-investments and government subsidies, reduces the likelihood of Intel pivoting on its strategy.

Fitch expects annual capital spending net of co-investments and subsidies of $15 billion-25 billion (low- to mid-30% of revenue), up from an average of $15 billion (20% of revenue) in the 2016-2020 period. R&D adds another $15+ billion in non-GAAP spending on innovation with potential moderation related to the company's recent restructuring program announcement, up from an average of $13 billion per year between 2016 and 2020. Fitch expects Intel will pursue additional co-investments and subsidies to defray spending levels, potentially reducing the drag on FCF.

Strong Market Positions: Intel's credit profile benefits from the company's still strong market positions in personal computers PC and DC, despite ongoing share erosion in servers to traditional competitor, Advanced Micro Devices Inc., and ARM-based custom servers. Strong growth in PCs, communications service providers, internet of things (IoT) and automotive markets should offset share losses. In addition, new product technology introductions over the next several years should stabilize share and potentially reverse losses.

Tower Semiconductor Acquisition: Fitch expects the proposed all-cash acquisition of Tower Semiconductor for $5.4 billion will add specialty technologies on mature nodes to IFS. Tower's expertise in radio frequency, power, silicon-germanium and industrial sensors and long-standing customer relationships strengthen Intel's ability to address faster growing mobile, automotive and power end markets, while Tower's footprint adds two million wafer starts per year of capacity in the U.S. and Asia. Fitch expects Intel use cash to fund the deal, which it expects to close in 2023, subject to certain regulatory approvals and customary closing conditions.

DERIVATION SUMMARY

Fitch believes Intel's weakened financial position within the context of its investment super-cycle and process technology disadvantage position it more in line with a low-'A' category rating. As a result, Fitch expects meaningfully negative FCF and weak leverage metrics over the intermediate term, which is inconsistent with the company previous strong 'A' rating. Beyond the intermediate term, Fitch expects stronger profit margins and FCF; however, a return to historical levels will require strong execution across a number of Intel's strategic initiatives.

Fitch's base case contemplates recovering end markets in 2024, aided by product refreshes that should stabilize market share while Intel's restructuring actions support profit margin expansion. Solid cash balances, co-investments and government subsidies should provide sufficient liquidity to fund capital spending, which over the longer-term positions Intel as a market leader with meaningful foundry services capabilities in the U.S. and Europe as customers look to diversify their foundry suppliers.

Intel faces intensified competition from rival, AMD, in both PCs and servers for DCs, as well as increasing utilization of custom ARM-based servers by service provider customers. Nonetheless, Intel's market share remains strong despite technology challenges and is poised to stabilize with new products set for production over the coming years, including those sourced from the company's increased use of foundry partner, TSMC, for advanced products. From both an operating and financial profile perspective, Intel is weaker than TSMC, given that company's significant leadership in leading edge foundry services, superior FCF profile and strong credit metrics.

The 'F2' short-term and CP ratings reflect correspondence with Intel's lower LT ratings. Under Fitch's Corporate Rating Criteria, an 'A-' LT IDR links to either an 'F1' or 'F2' ST IDR with the Financial Flexibility factor of Fitch's Global Technology navigator with a particular focus on the Liquidity sub-factor. In Intel's case, Liquidity will be challenged given the company's negative FCF over the rating horizon, yielding a 'bbb' sub-factor rating, as well as a 'bbb' overall Financial Flexibility factor rating, and corresponding to the baseline (F2) rather than higher (F1) ST IDR.

KEY ASSUMPTIONS

--Revenue down by mid-teens in 2023 reflecting weak demand conditions, excess inventory levels and market share losses in DC;

--Revenue begins recovering in 2024 and grows at high single digits through the remainder of the forecast reflecting improving competitive positioning and modest growth in IFS;

--Gross profit margins trough at 40%-45% in 2023 before expanding with the resumption of revenue growth, benefits from Intel's cost reduction initiatives and a richer sales mix;

--Intel achieves operating expense reduction targets and operating EBITDA margins trough at 31% in 2023 before returning to low 40% through the forecast period, given operating leverage in the model;

--Capital spending remains in the low- to mid-30% as a percentage of revenue with offsets from financial partners and government subsidies;

--Dividend growth is modest and no share repurchases;

--Intel completes the Tower Semiconductor acquisition in 2023;

--Intel refinances upcoming debt maturities and plugs cash burn with incremental debt.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Intel regains a greater than 80% share in DC markets while maintaining profit margins in line with industry peers, demonstrating technology leadership in the face of intensifying competition;

--Significant growth in non-PC and DC segments resulting in greater revenue diversification, underscoring the company's technology roadmap;

--Expectations Intel will sustain EBITDA leverage near 1.5x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Sustained negative organic revenue growth or non-GAAP gross profit margins in the 40% range due to a structurally weakened competitive position and product roadmap;

--Negative FCF beyond 2025, underscoring failure in the company's technology roadmap;

--Expectations for EBITDA leverage sustained above 2.0x beyond the intermediate term.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Modest liquidity: Intel's liquidity is modest and, as of Dec. 31, 2022, was supported by $11.1 billion of cash and cash equivalents, $17.2 billion of short-term investments, an undrawn $5.0 billion revolving credit facility (RCF) due March 2027 and undrawn $5.0 billion 364-day RCF expiring November 2023. The credit facilities fully back-stop Intel's $10.0 billion CP program, under which $3.9 billion was outstanding at quarter-end. Fitch expects Intel's annual FCF, historically providing significant support for liquidity, will be significantly negative over the next few years requiring a combination of contributions from financial partners, government subsidies or, potentially, debt financing to support investment needs.

ISSUER PROFILE

Intel Corp. is the world's largest integrated design manufacturer, providing integrated circuits and related products into computing, internet of things and communications markets, in addition to providing foundry services.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Intel Corporation	LT IDR	A- Rating Outlook Negative	Downgrade	A+ Rating Outlook Negative
	ST IDR	F2	Downgrade	F1
senior unsecured	LT	A-	Downgrade	A+
senior unsecured	ST	F2	Downgrade	F1

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 29 Oct 2022)

Corporate Rating Criteria (pub. 29 Oct 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Intel Corporation	EU Endorsed, UK Endorsed

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