CHIPPED AWAY

WITH SIZE INCREASINGLY NOT A DETERRENT FOR LARGER ACTIVIST HEDGE FUNDS, INTEL HAS FEW DEFENSES REMAINING AGAINST AN ACTIVIST INCURSION, WRITES IURI STRUTA.

INTEL

SECTOR:	MARKET CAP:	EXCHANGE:	TICKER:	HQ:
TECHNOLOGY	$230B (LARGE CAP)	NASDAQ	INTC	SANTA CLARA, CA

While Intel has been wandering into new business areas, its more focused competitors have been eating away market share in a space where it has long been an undisputed leader. The result of this strategic blunder has been significant underperformance relative to peers. According to *Activist Insight Vulnerability*, the company's total shareholder return (TSR) over the past five years is 72% versus 149% for the median peer, while its main competitor, Advanced Micro Devices (AMD), boasts a TSR of more than 1,000% for the same period.

AVERSE TO COMPLEXITY

Intel's issues may have started five years ago, when it announced a transformation strategy "from a PC-centric to a data-centric company," with big bets on memory, autonomous driving, and 5G. To pursue its plan, Intel concluded around 28 large and small acquisitions over the past five years, including Mobileye, a developer of driver-assistance systems which was bought for $15.3 billion in 2017, and Altera, a programmable logic devices manufacturer acquired for $16.7 billion in 2015.

The strategy has diversified the company away from its core business of designing and manufacturing microprocessors and instilled a greater degree of complexity, at a time when investors appreciate simple and straightforward businesses. When targeting AT&T in September, Elliott Management wrote in a letter to the board that "most companies today no longer seek to assemble conglomerates."

ACQUISITION BINGE

While Intel can hardly be described as a conglomerate, it has chased opportunities in adjoining markets, while leaving its cash cow vulnerable. As the company ploughed more than $30 billion into acquisitions during the past five years, it has failed to increase production volumes for its next generation of 10-nanometer chips, giving its arch-rival AMD an opening to grab market share in an area where Intel held near-monopoly power until recently.

Since the first quarter of 2018, AMD has increased its market share in desktop and notebook processors by around five percentage points to 17.3% and 13%, respectively, according to Goldman Sachs. Meanwhile, AMD's server processors business has a 3.1% share of the market currently versus 1% in the first quarter of 2018. "We expect AMD to accelerate its PC market share gains due to higher performance, lower power usage, lower cost, and ease of upgrade," Stifel analysts said in a research note in May after AMD unveiled the third generation of its Ryzen microprocessor.

> "AS THE COMPANY PLOUGHED MORE THAN $30 BILLION INTO ACQUISITIONS DURING THE PAST FIVE YEARS, IT HAS FAILED TO INCREASE PRODUCTION VOLUMES FOR ITS NEXT GENERATION OF 10-NANOMETER CHIPS.

Intel's initial mid-2017 deadline for the production ramp-up has been pushed back a few times and the company now expects a significant increase in volumes in the second half of 2020. As such, AMD will be unchallenged for at least a year with its 7-nanometer Rome server chips that are produced by outsourcer Taiwan Semiconductor Manufacturing.

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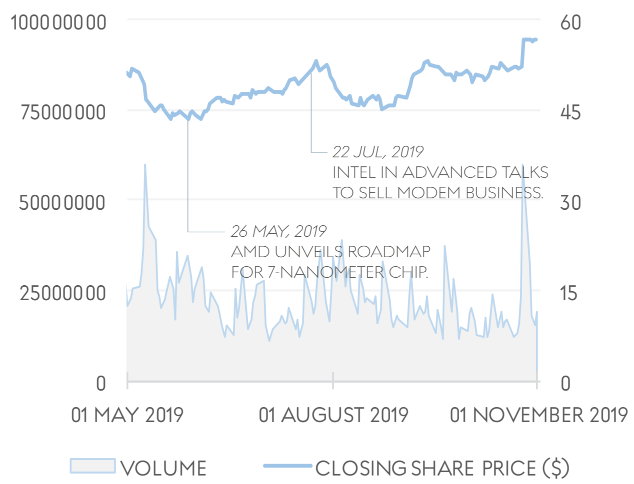
DIVEST AND LEAD

An activist could ask Intel to divest distractions and invest capital in bringing its new chip to market before it is too late. For instance, the memory and programmable semiconductors businesses are the least profitable of its five units, with the former breaking even this year after two years of losses. At the same time, a strategic review could find divestment opportunities across the company's business segments, particularly in non-core product categories such as connectivity, memory, and boards and systems.

Intel has already started making divestments. This summer, the company began talks to sell its modem chip business to Apple for $1 billion, conceding the 5G race to Qualcomm and the iPhone maker. More divestments would have to follow for the company to avoid scrutiny from activists, particularly if it fails to deliver on its self-imposed deadline to increase production of its new chips.

INTEL'S VULNERABILITIES

INTEL'S 6-MONTH SHARE PRICE PERFORMANCE



GOVERNANCE SNAPSHOT

The abrupt departure of CEO Brian Krzanich in 2018 after he admitted to a consensual relationship with an employee may be evocative of broader corporate culture issues. Bob Swan, who was picked by the board to replace Krzanich, has already had an encounter with an activist as the former chief financial officer of eBay, which spun off PayPal in 2015 despite a vigorous defense against Carl Icahn.

Shareholder discontent with the board's work has been gathering pace. At the May 2019 shareholder meeting, nearly 40% of the shares present voted against the executive remuneration policy, up from 5.6% in 2018. Many asset managers were unhappy about the pay structure for Swan and the disconnect between performance and compensation. According to *Activist Insight Governance*, Intel Chairman Andy Bryant is not independent, having joined the firm in 1981 and held several executive roles over the years. Around one-third of the shares cast in 2018 were voted in favor of a shareholder proposal requiring an independent chairman.

The nomination deadline for the 2020 annual meeting expires on January 17, which might be the easiest way to gain board representation. A proposal by John Chevedden to provide the right to act by written consent was marginally voted down at the 2019 shareholder meeting, while the proxy access rule necessitates shareholders collectively owning a $7 billion stake to join forces.