Intel in Bond Gambit to Rescue Ailing Stock: Corporate Finance
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By Charles Mead and Ian King
Dec. 5 (Bloomberg) -- Intel Corp. is taking advantage of bond interest rates below its dividend yield as the world's largest semiconductor maker borrows to buy back stock battered by its lagging share in the smartphone and tablet markets.
The firm issued $6 billion of debentures in a four-part sale yesterday with an average coupon of 2.38 percent that will help fund its stock buyback program. That's lower than Intel's indicated dividend yield of 4.5 percent on equity that trades at a lower price relative to earnings than every profitable firm in the 30-member Philadelphia Semiconductor Index.
Intel is enriching shareholders with borrowed money for the second time in 15 months after selling $5 billion of debt in September 2011. While its shares have underperformed as the Santa Clara, California-based firm and Microsoft Corp. struggle to combat Apple Inc. in the $63.2 billion tablet market, bonds of the industry's biggest generator of cash trade at tighter relative yields than the average for technology companies.
"They're essentially doing an arbitrage by borrowing at cheaper rates and retiring higher-cost equity," Alan Shepard, an analyst at Madison Investment Advisors Inc., which holds Intel debt and oversees about $16 billion in Madison, Wisconsin, said in an e-mail. "Given that Intel has relatively low leverage, this shouldn't affect its ratings."

'Arbitrage Play'

Intel's stock has fallen to $19.97, down 15 percent this year including reinvested dividends while the Standard & Poor's 500 has gained 14 percent. It's among 25 companies in the index with an estimated stock dividend yield that's higher than its average bond coupon, according to data compiled by Bloomberg. S&P 500 firms have an average equity yield of 2.18 percent with a 5.13 percent coupon, the data show.
"That's the arbitrage play that capital markets are presenting now because rates are so low," Dave Novosel, an analyst at bond research firm Gimme Credit LLC in Chicago, said in a telephone interview. "You've got very robust markets right now, with a lot of investor interest swallowing up paper, so it's a good time to come to market."
The offering was Intel's largest on record and exceeds the 2012 issuance of companies from International Business Machines

Corp. and Texas Instruments Inc. to Microsoft, Bloomberg data show. Those firms have borrowed a collective $8.75 billion this year as yields on investment-grade debt in the U.S. declined to record lows, reaching an unprecedented 2.73 percent on Nov. 8, according to Bank of America Merrill Lynch index data.

“The cost of money is relatively cheap,” Chuck Mulloy, a spokesman for Intel, said in a telephone interview. “We thought it was a wise time to go to the market.”

4-Part Sale

Intel sold equal $750 million portions of 4 percent bonds due in December 2032 and 4.25 percent, 30-year debt, as well as $1.5 billion of 2.7 percent 10-year notes and $3 billion of bonds due in 2017 that pay a 1.35 percent coupon, Bloomberg data show.

The deal was the largest dollar-denominated sale since Abbott Laboratories raised $14.7 billion on Nov. 5.

Bonds of Intel rose today, with the 2032 securities increasing 1.1 cents on the dollar to yield 3.9 percent with a 113 basis-point spread at 9:08 a.m. in New York, tighter than the extra yield of 130 basis points when it priced yesterday, according to Trace, the bond-price reporting system of the Financial Industry Regulatory Authority.

The 30-year debt that yielded 150 basis points more than Treasuries at issue rose 0.91 cent and yielded 142 more than benchmarks, Trace data show.

Stock Decline

Investors demand lower yields relative to government securities to own Intel bonds rather than those of technology firms such as Dell Inc. and Applied Materials Inc., Bank of America Merrill Lynch index data show. An average spread of 101 basis points on Intel debt compares with the industry’s 135. A basis point is 0.01 percentage point.

Falling borrowing costs have coincided with a stock decline that’s wiped $24 billion from Intel’s market capitalization this year as growth in its main market, personal computers, has ground to a halt in a weakening economy. The PC market is on course for its first decline in more than 10 years, according to estimates by IHS iSuppli and other market forecasters.

Smartphones, Tablets

That slowdown is being compounded by consumers increasingly turning to smartphones and tablets to get online, putting off purchasing computers. Intel, which supplies more than 80 percent

of the world's PCs with their main component, has less than one percent of the market for phone processors.
"They're not creating growth," William Larkin, a fixed-income money manager who helps oversee $500 million at Cabot Money Management Inc. in Salem, Massachusetts, said in a telephone interview.
Revenue in the third quarter declined 5.5 percent from a year earlier to $13.5 billion, Bloomberg data show. Trailing 12-month net income dropped for the third straight period, to $11.9 billion, the lowest since 2010.
Equity investors have responded by selling Intel stock, which traded at a price-to-earnings multiple of 8.3 on Nov. 21, the lowest level in 24 years, Bloomberg data show. A multiple of 8.57 yesterday compares with an industry average of 38. Texas Instruments trades at 16 times earnings.

Free Cash

"If you're trying to time stock repurchases, I am sure Intel isn't looking at the stock as being expensive right now," Jason Paraschac, an analyst at Fitch Ratings, said in a telephone interview. "They generate enough free cash flow that they can pay for their share repurchases from the organic cash flow they generate."
Intel generated $6.8 billion of funds that can be used to reward shareholders through dividends or stock buybacks, to reinvest in the company, or to pay down debt in the 12 months ended Sept. 29, more than the $6.3 billion that remained available for repurchases under the existing program and exceeding the funds generated by each of its competitors.
The company has spent $90 billion on stock repurchases and dividend payments over the last decade, Chief Financial Officer Stacy Smith said last month at the Credit Suisse Technology Conference. Intel increased its quarterly dividend to 22.5 cents a share in May, up from 21 cents, Bloomberg data show.

'Significant Cushion'

The firm purchased about $1 billion of its stock in the third quarter, less than the $5 billion of cash generated from operations, Smith said on an Oct. 16 conference call to discuss earnings with analysts and investors.
"They've done this before, so it's not as if they're embarking on a new strategy," Gimme Credit's Novosel said.
The company's leverage, or ratio of debt to earnings before interest, taxes, depreciation and amortization, may rise to 0.56 from 0.3 with the new borrowings, according to data compiled by Bloomberg data based on trailing 12-month Ebitda of $23.2

billion. That compares with an average gauge of 3.71 for semiconductor peers and 1.37 at IBM.
“Intel is a high-quality company,” Jon Duensing, head of corporate credit at Smith Breeden Associates, said in a telephone interview from Boulder, Colorado. “They have a significant cushion with respect to cash-flow generation.”

Credit Rating

The new bonds didn’t hurt Intel’s credit rating. Moody’s Investors Service assigned an A1 ranking to the debt, equivalent to the A+ grade it received from S&P and Fitch. Moody’s said Intel’s credit outlook is stable, reflecting its financial strength and the expectation that it will defend a strong market position.
“It’s hard to argue you shouldn’t lever here,” Doug Freedman, an analyst at RBC Capital Markets in San Francisco, who rates Intel’s stock a “sector perform” with a target price of $24, said in a telephone interview. “When interest rates are low, you borrow money.”

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