

AMD: Several Reasons To Remain Upbeat After The Equity Offering

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As we concluded our previous AMD comment a few weeks ago on “The odds of an equity issue are quite high, as the company will have one day or another to restore its shareholders’ equity”, we believe that AMD’s equity offering (\$600m) and convertible bond issue (\$700m, upsized from the originally announced amount of \$450m) did not come as a major surprise. The company’s balance sheet was in poor shape (\$1.3bn net debt and negative shareholders’ equity at end 2015) and needed to be fixed and the recent operating momentum and stock price rally made it easier (and less dilutive) to raise money.

Obviously, such a move is highly dilutive for shareholders as the share count is expected to pop by 13% (vs. 10% originally) and by 24% when taking into account the potential conversion in the future of the 2026 convertible notes (an \$8 strike is clearly within reach). These headline dilution numbers, as well as the surprisingly high discount on the offering price (\$6 vs. a \$7.30 price prior to the announcement), arguably drove the stock price pressure.

That said, we view this balance sheet repair positively, both on financial and strategic grounds. From a financial standpoint, AMD will be able to make huge savings on its financial costs as the \$1.26bn net proceeds from the equity offering and convertible note issue will be used to repay some of the company’s high-interest debt. As current debt carries interest rates around 7% (from 4% for borrowings to 7.75% for some of the existing notes) and as the convertible debt carries a much lower rate (2.125%), we believe savings on financial costs could amount to \$73m annually as detailed in the table below.

Note that \$73m additional income (before tax) is a huge number in light of AMD’s low (or negative) earnings expected in 2016 and 2017. If we try to assess the impact on FY18, which we expect to be a more normative year for AMD, the savings on financial costs would spark a 49% boost on net earnings.

In all, despite the share count increase, AMD could benefit from a material EPS accretion well above 30% in the base case and close to 50% assuming the convertible notes are converted into shares.

Estimated impact of the announced transaction on AMD's EPS (figures in \$m)

	<i>If convertibles are converted</i>	<i>If convertibles are NOT converted</i>
Annual interest to be paid on convertible notes @2.125%	15	0
Annual interests to be saved on existing debt @7%	88	127
Savings on financial costs	73	127
Impact on FY18 net income	49%	85%
Share count dilution	13%	24%
FY18 EPS accretion/dilution	32%	49%

Source: AtonRā Partners

Another major positive is that this balance sheet repair will lead most investors to ascribe a lower risk premium to AMD (or beta). If we slightly reduce AMD's beta (say from 1.2 to 1.1) in our DCF model (detailed in a previous article), the valuation increases by 15%.

In all, while some investors are selling the stock thanks to the headline potential 24% dilution, we view the deal as highly positive in terms of EPS and valuation impact.

Also, from a strategic standpoint, we believe that management will now be able to be fully focused on the business while, just a few months ago, it was probably more focused on the balance sheet and on cost savings when the company's viability was in question.

That suggests that AMD could be more aggressive in terms of R&D spending going forward, a necessary step in our view to sustain recent market share momentum and product introductions at a time when GPUs take a major role in artificial intelligence applications and when the company's Zen processors are expected to challenge Intel's.