

Nvidia's Ludicrous Mode

Impressive revenue acceleration confirms that Nvidia has entered into a new, massive growth cycle. We believe the recent price run does not fully capture the company's earnings power and that multiple expansion and earnings upside could drive Nvidia's valuation 25-30% higher.

Nvidia didn't disappoint investors who expected a massive quarterly beat as it blew away Q2 estimates (revenue up 24% year-on-year to \$1.428bn vs. a consensus of \$1.35bn, and EPS of \$0.53 vs. \$0.48) and delivered an impressive Q3 guidance (\$1.68bn revenue at midpoint vs. the Street at \$1.45bn and implied EPS around \$0.65 vs. \$0.53).

More than the beat itself, the underlying trends over the last quarters are eye-catching (from low single digit growth in Q1-Q2 last year to low teens in Q1 and low twenties in Q2) and confirm that Nvidia has entered into a new, massive growth cycle. And in line with our scenario and contrary to analysts' expectations, there will be no revenue slowdown in the second half of the year but a continued acceleration as the Q3 revenue guide points to 29% growth and as Q4 will likely grow around 20% (vs. a first-half revenue growth of 19%).

Unsurprisingly, the Data Center and Auto segments stand out in Nvidia's revenue outlook. After already impressive revenue performances in the previous quarter (63% and 47%, respectively), they skyrocketed in Q2 with 110% and 68% growth, respectively. We believe such explosive growth is unlikely to fade soon as both cloud operators and auto-makers are hungry for chips that boost their performances and enable new functionalities (deep learning applications for the likes of Amazon, Microsoft and Facebook, supercomputing needs for autonomous driving...).

The core PC gaming segment, which remained on a steady growth trajectory in Q2 (18% after 17% in Q1), should soon get a boost from virtual reality demand as gamers upgrade to more powerful GPUs. As the upgrade cycle is likely to last several years, the segment should keep growing in the teens until FY19 at least.

In all, Nvidia's revenue should grow at a ~20% CAGR (excluding the potential loss of Intel royalties in FY18) and, in our view, come with higher gross margins as the mix shifts towards high-end GPUs. Gross margins currently stand above 58% (vs. 56.8% last year) and could reach 60% as soon as next fiscal year while the Street remains on the conservative side (56-57% margins over coming years). This points to continued EPS upside potential and to an EPS CAGR we estimate around 30%.

One can wonder if this revenue and earnings upside is not already baked into Nvidia's current valuation in light of the impressive stock price run. The stock is currently trading at a 26x FY18 P/E on earnings which are 10-15% below our own expectations.

Our view is that an earnings growth around 30% can easily justify a P/E above 30x. **So, multiple expansion and earnings upside could drive Nvidia's valuation 25-30% higher for a stock price in a \$75-80 range.**