

# Intel case study

Business



Intel is positioned as a leading company with its ability to adapt to technological changes and its strong relations with other businesses who are major buyers of integrated circuits. The industry in which it operates is very competitive and comes with high risks as failure to produce a viable product can permanently lead them to exit the market. Intel has built its reputation as a company having consistency in innovation. They were the major innovators in the industry where they had major breakthroughs in microelectronics. It has also positioned itself as the major player which sets benchmark for others to follow such as Moore's law.

However being in a competitive industry, Intel faces attention threats from other companies who imitate its innovative products and therefore, affecting part of Intel's future revenue. Describe the current capital structure of Intel. Discuss the pros and cons of the large cash position. The current capital structure of Intel is mainly equity oriented. As observed from Exhibit 3 of the case, the long-term debt portion of Intel was 5.

77% of total liabilities and equity as of December 1991 whereas the equity portion was 72.44%.

Further, Intel prefers to have debt only if terms are most favorable to the company. Again, the company is cash rich. This can be observed from the fact that as of December 1991, Intel cash and equivalent ratio was about 36.

19% of total assets. An advantage of having large cash position is that it offers protection during tough times and when the future cash needs are uncertain. Since Intel is in semiconductor industry, it has very high research

and product development costs and having large cash balance to support these costs is beneficial.

Further, keeping in view the strong competitive environment and fear of “Clones” by others, Intel is constantly required to look for innovative products, which would need more funds for upfront expenditures. In these situations, large cash positions would help Intel to avoid taking loans from outside, and in turn interest costs, by using its own cash balances. A disadvantage of having large cash position would be that cash has an opportunity cost.

In other words, Intel could be forgoing profitable investment opportunities.

However looking at the data provided in the case, we can see that the cost of holding cash was small as they yield high returns, above 170 basis points above U.S. Treasury bills, through investing in investment grade rated above AAA.

Further, a cash rich company runs the risk of being taken over as tender may create pressure on the management team to perform better.

Observing Intel's growing performance over a period of time, it seems that currently it has no such problem. However in future, it may become a cause of concern for the company.

Compare the three methods of repurchases: open market repurchase, fixed-price tender offer, and Dutch auction.

In the open market share repurchase, the firm may or may not declare the repurchase. Depending on the market condition and the firm's position in the industry, the firm can decide when and how many shares to repurchase. The open market repurchase sends a weaker signal to the shareholders about

the stock undervaluation, compared to the Dutch auction and fixed-price tender offer. In spite of this, it is the most commonly used repurchase method used by the firms in US.

Open market share repurchase signals to the market that the company would rather invest in its own company than going for other profitable and riskier investments.

Open market repurchase also causes delays and will allow other investors to push up the price before Intel goes in and repurchases making it more expensive for Intel. In a fixed price tender offer, the firm announces the number of shares it plans to repurchase; the fixed price it is willing to pay per share and the duration till the offer is valid. If the number of shares tendered by the shareholders is more than the number of shares sought by the firm, it will purchase less than all the shares tendered and if the number sought is less than the number tendered then the firm can extend its offer period.

This allows the shareholders to tender some or all of their shares at a premium to the current market price. The problem with this approach is that the best price for Intel would be the one (lowest price), which will be worst for its shareholders.

In Dutch auction, the firm announces the number of shares it plans to repurchase; price range it is willing to pay for the shares and the offer duration. The shareholders respond with the price and the number of shares they are willing to tender.

The firm then creates a demand curve of the stock from the tenders/responses received from the shareholders. The firm then selects the arches price that is the lowest price that will let the firm buy back the number of shares it seeks. If the number of shares tendered is lower than the number sought, the firm will buy less whereas if the number tendered is more, the firm can cancel the offer or buy back all the shares tendered at the maximum price.

Dutch auction is a quick process and will allow Intel's shareholders to sell their shares at a price they feel comfortable.

What is the implication of paying dividends? That is, what are the pros and cons of dividends? The pros of dividend are that when a company makes profit, the dockworkers expect a share of this profit. The dividend attracts investors to hold on to their shares and not sell them, as well as some investors reinvest or buy more stocks from the dividends they earn. Thus, Intel can retain their investors.

The cons of paying dividends are that investors might expect to receive the dividends always in future and might be disappointed if Intel stops paying it in future. Furthermore, Intel has to pay taxes to distribute the dividends and will not be able to get tax shield for this expense.

Also, sometimes investors react negatively to dividends as they think of it as a slogan Tanat Intel does not have good plans Tort Utter growth Ana develop further innovative products. Dividend payment can also reduce the price of share and thus reduce market capitalization.

Evaluate the package of two securities (put-warrant and convertible offering) from a capital structure point of view. Convertible bond is a type of bond in which the holder can convert the bond into specified number of shares by paying the conversion price before the final conversion date. When the firm issues the convertible bond, the debt of the firm increases and hence the debt-to-equity ratio (D/E) increases, whereas when the holder converts the bond to shares the equity of the firm increases, thereby decreasing the D/E ratio.

Put-warrant is a type of security that gives the holder the right but not the obligation to sell the share to the firm at the initially agreed upon price within a specified time.

When a firm issues a put warrant, its equity increases and therefore the D/E ratio decreases but when the holder exercises his right and sells the share to the firm, the equity of the firm reduces from the repurchase and thereby the D/E ratio increases.