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Reinventing an Industry: Putting the Customer First

Introduction

Thank you Dan, and thank you to the Commonwealth Club for having me here.

I was invited to speak with you tonight about the "David & Goliath" dynamic that has in many ways defined the semiconductor industry. And you know, I don't necessarily mind that positioning, as we all know how the story ends.

But this David and Goliath battle is about much more than AMD, our much larger competitor, or the industry itself.

It has been said that Information Technology is the 21st century's oil: it is the platform for a scope of innovation, productivity and economic growth that has and will continue to fundamentally alter the way we live, work, learn and play.

Over the last decade, the United States has enjoyed a sustained increase in the growth of productivity, sparked by an exponential surge in computing performance. You don't need me to tell you that productivity is the key to long-term economic growth and job creation. Information technology empowers businesses – from retailing, to commerce to financial services, to manufacturing -- to revolutionalize the way that they do business and thus make the economy ever more productive.

As the Chairman of the Federal Reserve Board explained recently, "Increased computing power has… contributed to advances in other fields, such as biotechnology, and has helped to increase the range of goods and services available to businesses and consumers."

And what makes the IT revolution run? At the very soul of the IT industry is the x86 microprocessor – the brain of almost all the PCs and servers in use in the world today. It is the foundation from which IT is built, and its universally adopted architecture creates a common platform for all to innovate from. There is absolutely no question that without the x86 processor, the IT industry would not have the influence it commands today.

The implications for economic growth are obvious. The entire economy – and all other economies that wish to grow – have a stake in ensuring that the microprocessor industry is as vibrant, creative, innovative and efficient as possible. That it is, in order words, fully competitive.

It is not an exaggeration to say that how these two companies choose to compete and has implications that affect the world.

David & Goliath

First, for those of you unfamiliar with the semiconductor industry, a bit of background on our industry's "David and Goliath"

As many of you know who have followed AMD through the years, this question of how we compete against our much larger competitor has at times been a challenging one. The numbers can be daunting:

- For the fiscal year 2005:

	AMD	Intel
o	Sales: 5.85B	Revenue: 38.8 billion
o	Net Income: 165M	Net Income: 8.7 billion
o	R&D: 1.14B	R&D: 5.145B

- Their manufacturing capability is immense: Eleven Fabs worldwide, six assembly & test sites, and approximately 39,000 employees in their Technology Manufacturing group.

- Their entrenched position in the market makes them a super-dominant monopoly – that is, a monopoly that holds an overwhelming revenue share in an industry. According to Mercury Research, for the first half of 2006 Intel held just over 80 percent of the x86 revenue share on a global basis.

Making our chances of success even slimmer is their abuse of their monopoly position to illegally limit competition. Last year Intel was found guilty of monopoly abuses in Japan, and is currently under investigation by, among others, the European Union, the Korean Fair Trade Commission and the U.S Federal Trade Commission. And we filed our own lawsuits in the U.S. and Japan to prevent Intel from strong-arming customers to exclude or limit the business they do with us.

Because of the quality of our products, regulatory and legal actions around the world and the renewed courage of the industry to break free from a monopoly, AMD is gaining momentum. For the second quarter of 2006, we announced sales were up 53 percent year-over-year, and recorded the twelfth consecutive quarter of greater than 20 percent year-over-year microprocessor sales growth. In July we announced that we will be welcoming one of the great leaders in the semiconductor industry – ATI – to the AMD family, an acquisition we hope to close late next month.

How are we succeeding in our David and Goliath industry? And why is this battle critical not just for AMD, but for the long-term health of our economy?

The answer begins with understanding how our industry's Goliath has abused its monopoly position and stunted the growth of our industry.

An Abusive Goliath

Monopolies, at all costs, must protect their market share in order to preserve their business model. Without overwhelming market share, a monopoly's business model begins to fail. As we have learned through history – whether it be in the railroad, oil, or communication industries, it is in the face of this threat of market share loss that monopolies can turn abusive, and illegally leverage their dominance to limit competition.

In the semiconductor industry, our competitors' illegal tactics to hold onto to their market share have not only limited competition, but have also come at the tremendous expense of the rest of the industry's attempts to either innovate or grow.

During the last decade, our industry's customers – the companies that make PCs, servers or handheld devices - have seen their brands severely damaged as the monopoly took away any opportunity to meaningfully leverage innovation or marketing to differentiate themselves. Over time, consumers lost any sense of difference between the rows of computer boxes lined up in front of them. And as a result, where our customers' value proposition to the consumer used to be one of performance and innovation, it is now almost exclusively based on price. Profit margins have been slashed, creating a destructive race to occupy the low-ground. Many have even called the PC business a "loss-leader" for our customers.

And remember: the P & L destruction of the industry's customers was occurring while the industry's monopoly was enjoying operating margins that surpassed Microsoft's.

The net effect: With the monopoly turning their customers into commodities, it should be no surprise that growth in the semiconductor industry has reached what many would call "mature levels."

Don't be fooled by this label – it is a lazy term at best, and an extremely dangerous one at worst. How could our industry possibly have reached mature growth rates when only 16 percent of the world has access to the Internet? How could this industry be called "mature" when we have barely scratched the surface on where, how and for what our technology can be used?

No, our industry growth rate has slowed largely because of the abusive practices of our industry's Goliath – an illegal monopoly that at all costs is trying to maintain control over an industry to protect its business model, and has narrowed the pace of innovation and availability of choice to suit its own needs rather than that of its customers.

As we discuss tonight - this battle between a David and Goliath - it is important to remember the nature of the battle. This is not a battle limited to AMD and Intel. It is a battle of an industry trying to break free from an abusive monopoly in order to bring innovation, differentiation, choice and – most important of all – profitable growth for all back to our industry. It is a battle about the future of one of the most important and foundational industries in the world.

A Call for a New Deal

An important period in our industry's David vs. Goliath battle is 2001-2002, when the semiconductor industry experienced the equivalent of an economic depression.

- On average, revenue dropped 33% among the top 25 semiconductor manufacturers in 2001.

- On average, capital spending decreased 28% among 10 of the top semiconductor companies in 2002.

- The global semiconductor market topped $200 Billion in sales in 2000, an industry record, and then plummeted to $139 Billion in worldwide sales in 2001.

- U.S. computer shipment sales, which had averaged a 29% annual growth rate from 1993-1999, experienced a sharp decline throughout 2001 and the first half of 2002, at one point declining just over 30%.

Perhaps the only good to come of this severe industry downturn was how thoroughly it exposed the abusive practices of the monopoly. With demand in a slump, customers could literally not afford to operate under the conditions the monopoly imposed: technology that had little relevance to the needs of end user; a one-size-fits-all approach to solutions that left no room for differentiation and crippled efforts to expand into developing markets; and a near complete lack of choice that prevented any meaningful leverage in price negotiations.

It was during this industry depression that I became CEO of AMD. It was April of 2002, and, like many other industry participants, we were hit hard. In that year AMD had an operating loss of more than $1.2 billion on roughly $2.7 billion in sales. Our stock had dropped to around $3/share. To try to better understand how we could make our way out of this mess, I went on the road to meet with customers. My question: what do you need from the semiconductor industry to break this depression?

What I heard was heartening. Customers were calling for a New Deal from the industry. They were asking for new types of innovation – innovation that had less to do with testing the theoretical limits of technology and more to do with what mattered most to their customers: cost of ownership, energy efficiency, compatibility and ease of implementation. They were asking for choice – a choice in products and solutions that would enable them to differentiate their value proposition and brands to their customers. They told me they needed AMD to deliver innovation and choice. They told me they needed us to break the monopoly. They told me if AMD could deliver, they would become valuable customers.

With this pledge in hand, I returned to meet with my team to create a set of strategies that could deliver on the New Deal customers were asking for.

The AMD Battle Plan: Putting the Customer First

Before I even joined AMD, I knew from my work as President of Motorola's semiconductor products sector that AMD had tremendous assets. One of these assets was AMD's deep and subtle understanding of customers. AMD's years of battling its far larger competitor had forced it to look for even the smallest of advantages – many of which it found through spending extensive time with its customers.

This insight became extremely valuable as we began architecting a new strategy for our company.

For example, we knew that years of rapidly adopting large quantities of technology had made our customers far smarter about what they needed. No longer should innovation happen behind closed doors, but in full partnership with our customers and business partners.

We knew that what customers were demanding was becoming increasingly complicated to develop and manufacture, requiring a deeper level of partnerships and manufacturing flexibility than before.

We knew the days of forced ingredient branding had harmed and embittered the industry, and now customers were demanding – and deserving – to reclaim control of their brand equity.

To reinforce our corporate priority, we labeled our new business strategy "customer-centric innovation" and it affected every aspect of the company: engineering, manufacturing, sales, marketing, human resources and our legal strategy. Most important to the strategy's success, it was a perfect fit with the AMD culture and employees, who have aggressively and successfully executed against it.

AMD has enjoyed some success since embracing this strategy. We have won customers whom many claimed were untouchable. In the x86 server market, we've gone from zero market share in the U.S. to just over 25 percent. We are flexibly expanding our manufacturing capacity to meet any size demand. And our healthy, improving balance sheet has afforded us the tremendous opportunity to acquire one of our industry's finest companies: ATI Technologies.

The more important success however, has been that of the industry and our customers.

For example, just last month, Hewlett-Packard released earnings the included operating margins for its PC business of 4 percent. Just over four years ago, their PC operating margins were negative 4.9 percent.

Similarly, Sun Microsystems is also experiencing renewed momentum, particularly in their server business. Since introducing a line of x86-based AMD Opteron servers just two years ago, Sun has climbed from #16 to the #6 position in worldwide server revenue. Days ago, they announced server revenue gains of 15.5%.

Even the monopoly has responded. Last quarter, Intel sent strong signals it was abandoning its Itanium processor, a technology that epitomized their arrogance and abuse by forcing customers to spend tremendous amounts of unnecessary money on software and implementation. At the same time, they launched to broad, critical praise, a new processor family that deserves our respect.

While AMD's products alone cannot lay claim to these increased prospects for our industry and customers, there can be no doubt the greater choice and competition they reflect has benefited everyone.

Unfortunately, even with these tastes of success, the bitter reality is the monopoly and its abusive practices remain.

Despite the attention our lawsuit has focused on the need for fair and open competition, our customers continue to report our competitor's abuses. These reported abuses include threats to limit their supply of our competitor's products if they do business with us or, just as bad, outright payments not to engage with AMD at all.

Let me offer an example. Though we have offered highly competitive products in the commercial desktop and notebook space for many years, have you noticed it was not until last month that the first Tier One OEM – our industry's biggest and most strategic customers - was bold enough to offer an AMD-powered enterprise level desktop machine to their Fortune 1000 customers?

Moreover, customers who wish to expand their AMD relationship tell us that the savings they would derive from buying AMD would be wiped out several times over by retaliatory price increases on processors they must continue to purchase from our competitor.

As a result, the desktop and notebook market share gains AMD has experienced have been won largely in the consumer space, where very high selling costs leave little profit to fund further expansion and product innovation.

Clearly, our work to establish a free and open market must continue.

Our Industry's Potential

In the semiconductor industry, growth is an outcome of customer-focused innovation and choice. And both our business strategy and lawsuit are meant to preserve innovation and choice in our industry – a style of innovation that is richly valued by our customers and a choice in solutions that will bring competition, innovation and opportunity for all.

Just as exciting for me, if competition and choice are nurtured within our industry we will dramatically expand our ability to positively impact on the world. With our global reach and capacity for innovation, we have the rare ability to truly change the world for the better.

And perhaps, this is what is most frustrating about having to fight for simply the chance to compete in a fair and open environment.

Our daily concerns should not be about breaking free from a monopoly, but rather how our innovations can contribute to eradicating poverty or to finding a cure for cancer.

We should not be forced to spend money on lawyers to fight a battle in court that should be fought in the marketplace. We should spend that money on creating the specialized solutions the developing world needs in order to Internet-enable the remaining 84 percent of the world's population.

And we should not have to use precious opportunities with audiences such as this to explain a lawsuit, but rather to engage in a dialogue about our corporate and social responsibility to solve some of the world's greatest challenges.

Conclusion

I'm proud of the success AMD has enjoyed since 2002. But I'm even more proud of the way we've achieved that success.

For decades now, AMD has valiantly fought the Goliath – and that it survived those battles is a testament to its passion, resiliency, culture and leadership.

Four years ago, facing extinction, we knew we had to once and for all change the dynamics of the battle. We knew this was not a battle we could win alone. By delivering a New Deal to our customers and creating an environment that allowed our partners to win, we became a band of Davids fighting collectively for the freedom to compete, innovate and choose.

Today's battle is not just about AMD surviving, but also about an industry that wants to grow and thrive. It is about a global marketplace from the enterprise data center to the rural poor who want and need great, affordable technology. It is about a battle to reinvent one of the most powerful industries in the world. And hopefully, soon, this battle will be defined wholly by the decisions of customers, rather than the decisions of judges.

Thank you for having me here tonight.