Goldman Sachs Technology and Internet Conference

Company Participants

- Chris Evenden, IR Director

Other Participants

- James Schneider, Analyst, Goldman Sachs

Presentation

James Schneider {BIO 15753052 <GO>}

Good morning, everybody. Welcome to the Goldman Sachs Technology and Internet Conference, the Nvidia presentation. With us from the company today, we are very happy to have the Director of Investor Relations, Chris Evenden. Welcome Chris.

Chris Evenden {BIO 18934997 <GO>}

Thank you. Good to be here.

James Schneider {BIO 15753052 <GO>}

So Chris, you just reported a pretty fun quarter last night above the high end of your guidance. And you guided a little bit better than -- or maybe in line with seasonal but off of a higher base --

Chris Evenden {BIO 18934997 <GO>}

Much higher base, yes.

James Schneider {BIO 15753052 <GO>}

And I guess people are saying hey, our PC is back. And I think clearly the desktop business was probably up more strongly than the notebook business is fair to say. Can you help us understand where the underlying dynamic -- is it really just gaming applications being very, very, very strong above and beyond what the PC market is doing. And maybe talk about kind of the underlying trends in the OEM PC business as well?

Chris Evenden {BIO 18934997 <GO>}

Yes. So we have a GeForce product line that is graphics for consumers. And the most informative way to think about that, if you like, is dividing it into a gaming market and

an OEM market. And those two markets have very different dynamics, as Jim was alluding. So although having said that, both of them were actually strong in Q4, the OEM one probably more unexpectedly.

But the long-term underlying trend is that gaming is strong and the OEM business is weak. The OEM business is princely mainstream notebook. And that's under a lot of pressure. The mainstream notebook market as a whole is under a lot of pressure, right? We all know that. And I think there's additional pressures within graphics within mainstream notebook as well. So I think there's a lot of pressure in that business.

Gaming, however, is actually a very strong, profitable actually slowly growing business within the PC market. So you take -- you can't take a homogenous view of the PC market. It has very distinct segments. Gaming we estimate is growing at about 10% a year. And obviously Q4 is a strong quarter for gaming. But also because a lot of games come out in Q4 and people don't buy GPUs -- gamers don't buy GPUs because they want a better GPU. They buy GPUs because they want to play Battlefield 4 with all the features turned on, or they want to pay Blade and Soul. And I think the reason I mentioned Blade and Soul is that's a game that launched in China last quarter from Tencent. And that's a new departure because it's much higher production values than is typical for China. And although I am only talking about one game here, I think it's a very significant difference because it's raised the level of expectations of what a game in China can look like. And so we are pretty excited about that.

And China has been historically about 40% of GeForce revenues, just as a rule of thumb. And so if we can get them moving up in terms of ASPs, that's a very exciting opportunity for us. So dynamics, both markets were strong. But I would say the longer-term underlying trend is that PC gaming will continue to be strong. OEM I think is somewhat of a headwind in the next 12 months.

James Schneider {BIO 15753052 <GO>}

And are you seeing any kind of tailwind from market share versus AMD, or is it more just kind of strong share, still flat but the markets are doing what they're doing?

Chris Evenden {BIO 18934997 <GO>}

The market share numbers will come out today or tomorrow, I think. So we will see. A word of caution with market share numbers, they're unit share and there's a lot of difference between the OEM business and the gaming business in terms of both ASP and in terms of gross margins as well. So you can actually move -- excuse me, you can move market share very significantly and actually probably move profit dollars (inaudible) one quarter like Q3 of last year. We actually lost market share. But we increased our dollar share of the market. So it's good to have data and market share as one data point. But you've got to be cautious about interpreting it too literally because most of the money is made in the higher-end business. And by high-end, I'm talking about a graphics card that retails at like $150, or to $1000. But

really starting at that sort of level. So it's not stupendously expensive. That's where the money is going.

James Schneider {BIO 15753052 <GO>}

Got it. And relative to the Q1 guidance, I think you guided revenues down about I think about 8% sequentially at the midpoint. Can you maybe talk about the moving pieces within that, because clearly there's a lot of them. One is Tegra seasonality is particularly weaker in Q1. Nobody really knows what seasonality in Tesla in the professional business is. So help us kind of break apart the seasonality in the core PC and gaming franchise versus the rest.

Chris Evenden {BIO 18934997 <GO>}

Yes, I think seasonality is a really dangerous concept when it comes to Nvidia, because I think it implies that you know something when you don't. If you look at historically what other businesses have done, there probably is an underlying seasonality. But my God there's a lot of noise on top of that seasonality as well. And so it's difficult to use that as a basis.

Now, in terms of guiding into Q1, I think we guided pretty much in line with everybody else. We had a stronger Q4 than everybody else. So and even when you go down 8%, which is the midpoint into Q1, that still gives us a stronger -- if you look at it like Q3 to Q1, we are still stronger than pretty much all our peers I think Q3 to Q1. So I think it's good guidance. We will be up 10% year-on-year. The moving parts within that, certainly the GeForce business will be down significantly, both Desktop -- both gaming and OEM will be down significantly in that period of time. The professional business will be strong I think. And offset some of that. And Tegra will be wherever Tegra ends up.

James Schneider {BIO 15753052 <GO>}

That's helpful. I want to kind of switch from the near term to kind of the product side of things for a minute. You announced the latest in your Tegra series, the Tegra K1, back at the Consumer Electronics Show. I think the metrics you put around that were, say, 65% less power at any given performance and 40% more performance in any given power. I think that's what you said. But basically, can you help us understand first of all what are the advantages of K1 relative to Tegra 4 in the past and then what are the advantages relative to other competitors like a QUALCOMM-based solution or even other competitive solutions like X and Os or the Apple iPad?

Chris Evenden {BIO 18934997 <GO>}

Yes. So both questions have the same answer. And that is it's the first time you've got a PC plus GPU inside a mobile power. So it fits -- don't get me wrong, it fits within a mobile power and we can run it at 5 watts in a tablet, we can run it at 2 watts on a phone and still be in terms of per watt and raw performance. But it is PC class. So what does that mean? It means it has all the features of open GL for its DirectTouch 11. We worked with Epic support Unreal Engine 4 to it. And Unreal Engine is one of

the most popular game engines in the world today. So that means it makes it very easy for a game developer to take a game that already exists on another platform and makes it pretty trivial actually to port it to Tegra K1.

In fact, one of the demos we showed at our analyst day was a PC demo running on Tegra K1. And another one (inaudible) at CES. One was a PC demo running on Tegra K1 on the Unreal Engine. And another one was actually a PS4 demo I think on the Unreal Engine on Tegra K1. So that shows you just how easy it is to transfer that contract across. Of course, that's a big deal for a software developer because now it's a very little incremental asset that can make a game available on Android.

Then the other thing is it brings CUDA, the GPU general-purpose GPU program (inaudible) CUDA with its 192 processor cores to mobile. And so that gives you a lot of more options in terms of other features that you can add, because just as a GPU is good at taking data and turning it into an image, it's actually really good at taking an image and turning it into data. So image processing. And a bunch of other highly powered computing tasks as well. So we demonstrated it and the automotive context in terms of identifying the white lines on the road, reading road signs at the side, measuring the distance to the car in front, all these things. You have fundamental building blocks of advanced driver assistance systems. But in phones and tablets as well you have gesture control, facial recognition and all these other apps, high-definition -- high dynamic range photography, all these other apps can run in CUDA as well. So there's a lot of features and performance that brings that you didn't have before. And that's why we didn't call it Tegra 5 because we felt it was sufficiently big (inaudible) emphasize the fact that it's got the Kepler core in it and Tegra K1 as well in terms of that. That's a differentiation. And it's part of our fundamental strategy in terms of gaming on Android. So Android, again, is all about being ubiquitous; it's all about being everywhere. And we believe that as Android matures as a platform, there will be distinct segments that will crystallize out, if you will, out of the Android market. And one of those will be gaming. And we will be at the Vanguard of that and we intend to be the incumbent as that market solidifies. And part of that -- it's a bit of a chicken and egg problem in the sense that game developers don't want to develop games until they've got an installed base. Hardware manufacturers don't want to build an installed base until they've got games. And so we have to invest to build the gaming ecosystem on Android and Tegra K1 is part of that investment. Shield is part of that investment. Our game works team under Tony Tamasi is part of that investment as well. So this is a team of several hundred engineers that work with game developers to bring content to those platforms. So all of those things I think will build gaming on Android. And that's where we can build a strong, defensible, profitable segment for ourselves.

James Schneider {BIO 15753052 <GO>}

You mentioned (inaudible) side and get back to that. But if I look at kind of the rest of where Tegra is focused, how much do you see this as a tablet platform versus a smart phone platform. And then how do we think about the kind of dual core and quad core versions of the product out there?

Chris Evenden {BIO 18934997 <GO>}

So definitely more tablet than phone. We said that last year as well. And then Jammy came along and we had a big phone. But I would say that, strategically, it's much more focused on tablets. There's more room to differentiate the visual experience on a bigger screen fundamentally. But yes, I'd put it that way.

James Schneider {BIO 15753052 <GO>}

And dual core versus quad?

Chris Evenden {BIO 18934997 <GO>}

It depends on the application. So it's hard to be specific about that. There's a certain amount of what some generously call market texture. You come up with an eight-core processor because eight cores are obviously better than four. And even though you can't actually demonstrate that in any real-world sense, it works with the consumers. Eight is a bigger number than four. And that definitely helps out. So there are places for both types of architecture.

James Schneider {BIO 15753052 <GO>}

And what is the importance of 64-bit for Nvidia? Is that another market texture kind of thing, or is there actually real application (multiple speakers) really wanting to use (multiple speakers) software?

Chris Evenden {BIO 18934997 <GO>}

So silicon is a chicken and egg situation here as well, that you need 64 apps to take advantage of the architecture and they'll come on. But clearly the market is going in that direction. At five years' time, we won't be having a debate about 32 bit versus 64 bit. Everyone will be on 64 bit for the whole range.

So the question is what benefits accrue to being first? I think we are first. So I think that will benefit us in some sense. There will be apps that support 64-bit. And then there's the fact that you can pitch to a consumer that you've got a 64-bit tablet and the other guys only have got a 32-bit tablet. And so there's absolutely an element to that. But absolutely as well there will be features and applications that will take advantage of that 64-bit architecture when it's available.

James Schneider {BIO 15753052 <GO>}

Got it. Then I want to understand the modem strategy, because here there is an area where you made an investment or an acquisition of Icera. You've definitely done some proof points and last year you got CAGR certified. I think you -- that's been a pretty big success.

Chris Evenden {BIO 18934997 <GO>}

Yes.

James Schneider {BIO 15753052 <GO>}

Can you talk about how critical the integrated modem versus the discrete modem is to the overall mobile strategy for you?

Chris Evenden {BIO 18934997 <GO>}

That's really difficult. I thought you were going to ask me a much easier question. But I think modems -- let me answer the easy question and then I'll change the subject and we can move on.

The modems themselves I think are incredibly important. I think connectivity and cellular connectivity is going to be crucial whether you're in cars, whether you are in tablets, whether you're in a shield-like gaming device. Whether that needs to be discrete or integrated is actually a much more difficult philosophical question.

Integrated, the principal advantage of integrated is that it's cheaper. You can argue also that there is a power segment. But the power segment is really trivial in any meaningful sense. There's also a floor plan saving for integrated. But in the space we play in, the floor plan is pretty darn big, from a 4.3-inch phone and up. So you really are not too constrained about floor plans. So it stands for cost-saving. And again we compete at the high end. So the relatively small cost saving again from that is not a make or break feature.

Now, the advantage of going discrete is you can interact more quickly and you reduce risk because you can iterate separately on two very complex processes at the same time without impelling the schedule of the other. So where we play, discrete is actually a good solution. Having said that, absolutely there are market segments in which at some point you get down to where price becomes an imperative. And at that point, then integrated becomes much more important.

James Schneider {BIO 15753052 <GO>}

Then I just want to kind of touch on the obvious question which is about design wins, because I think we've had a couple of different junctures in the past where you've had performance leadership, you've blown away the competition in positive performance, in different kinds of performance metrics. But it really hasn't translated into market share. So what gives you confidence that this year is going to be the year that's different in terms of either tablet or smartphone design wins. And is it something we should simply be looking at Mobile World Congress and Computex beyond that and we should say ah, now I understand? Or how should we think about the design win traction and more importantly the outward visibility of that?

Chris Evenden {BIO 18934997 <GO>}

Yes. So we have pretty good visibility certainly into the phone side, less so into tablets because they have a shorter product cycle. But it's difficult for me to discuss

without verging on guiding the year. And I absolutely do not want to guide the year, because that has proven to be more difficult than we thought I think.

So we should have Tegra K1 32-bit devices shipping in the first half. We should have 64-bit devices shipping in the second half. We should have Tegra 4i smartphones shipping in the first half as well. But in terms of numbers and stuff, I don't want to dive down that rat hole.

James Schneider {BIO 15753052 <GO>}

Understand. I think that K1 is the first one where you've kind of introduced this Denver core you talked about --

Chris Evenden {BIO 18934997 <GO>}

Yes.

James Schneider {BIO 15753052 <GO>}

You've talked about this Denver core for a long time now. What does that really bring to the table for developers, for consumers. And --

Chris Evenden {BIO 18934997 <GO>}

It's the first 64-bit platform that is available. So it gives you the performance and features of a 64-bit platform. It gives you the adjustable memory space of a 64-bit platform. And I think we're first to market with it. Certainly we're the first to demonstrate Android running on 64-bit. We'll see how that goes.

James Schneider {BIO 15753052 <GO>}

Does it kind of -- is there a threshold of performance for example in the automotive market for the machine vision and that kind of stuff where you couldn't have got there if you didn't have 64-bit? Or what are the capital applications you can say now I really crossed the threshold and that enables me to (multiple speakers) application?

Chris Evenden {BIO 18934997 <GO>}

That's a really good question. I'm not sure I've got a very good answer for it. The image processing is run on the CUDA course, because a fully programmable GPU is a much more power-efficient place to do image analysis than a CPU. And you've got 192 cores. So you're running a massively parallel problem like image processing, it makes much more sense to do it on a GPU than on a CPU. I don't have any good examples of how 64-bit enables different platforms. I'm sure somewhere we do. And I'll do some work on that and figure out -- get you some examples on that. But I don't have it with me right now.

James Schneider {BIO 15753052 <GO>}

Kind of the next natural question related to this is, hey, you've got these other data center players in Grid and Tesla. And etc. Now you have a 64-bit ARM processor which is out in the market with a lot of performance. Why not go out there to be on several markets with this?

Chris Evenden {BIO 18934997 <GO>}

So well, there's different (inaudible). So our differentiation in service today is power processing, through whether it's Tesla or grid, it is about the power processing. That's the different and that's where we can -- that's where we are succeeding. I mean, look at where Tesla is. Tesla is growing very strongly. It grew 37% last year year-on-year and I would expect it to carry on growing this year as well. And it's a very, very profitable business, as you know.

Grid, I don't have revenues to point you at right now. But it is -- the number of trials is increasing. They increased over 40% quarter on quarter the number of trials. And so the purchase cycle in enterprise IT is 18 to 24 months. So it's a while before that turns into revenue. And I don't have a revenue number to point you at. But right now it looks pretty interesting.

Going into like general ARM servers (inaudible) something like that, that you need a differentiator in that. So Cavium and MCC would talk about their networking infrastructures and AMD would at well to some extent and AMD would probably also talk about their very real experience they have through years of their Opteron business. So Intel is in there. Rumors are that QUALCOMM, Samsung. And a bunch of other people are in that space as well. I think that's going to be a very hard-fought space over a small number of customers as well.

So you look at the market and you think that sounds like a big market but actually there's probably, after you've gone out of the first three customers, it is suddenly a much smaller market than you think. So that's a difficult place to be. Never say never. But right now that looks like a difficult place to be.

James Schneider {BIO 15753052 <GO>}

So no thanks for now.

Chris Evenden {BIO 18934997 <GO>}

No thanks for now, yes.

James Schneider {BIO 15753052 <GO>}

Okay, got it. Automotive, that is one where you've clearly demonstrated some level of traction with the Audi kind of self-driving car, the machine vision kind of capability.

And there you actually have given numbers. You've said I believe $450 million in calendar 2015 I think from around $100 million that you did last year.

Chris Evenden {BIO 18934997 <GO>}

Yes. It should go -- it's increasing at a very rapid rate. So I think what we said was -- what we did say is $100 million, $200 million, $400 million.

The other number we gave. And I mentioned this on the earnings call yesterday, is we have about a $2 billion pipeline. And I think that's the number I am most confident about because I don't know exactly when that $2 billion is going to arrive. Its model is moving to different quarters and so on. But the basic point being there's billions of dollars of order commitments. orders (technical difficulty) technical term. But commitments, design wins that we have in the pipeline. So that's obviously a very good business but the product cycles are very long. We have a real differentiation in that business as well, both with regards to processing for advanced driver systems, which everyone is looking at. And also in terms of actually even the raw graphics performance is starting to really matter in cars, whether it's how quickly your nav system updates. If it announces many updates once a second, it's really annoying. Or now we go moving to full digital dashes. So instead of having physical dials and needles, you will -- actually it will all be pixels. And that's what Audi was announcing at CES was -- part of what Audi was announcing the Tegra 3 was going to be powering the next generation of digital cockpit. And there graphics actually matters because the quality of their expense, the quality of your experience with the car is now so heavily influenced by the quality of the (inaudible) that's around you because that's your interface with the car to a large extent. And just as it used to be, inlaid walnut and handstitched leather on a dash that said something about the quality of the car, now it really is the quality of the pixels. Have I got an especially good quality display. And I've experiences that myself when I look at cars and being put off just because their electronics was wrong. So I think that's going to be a very important differentiator for us.

James Schneider {BIO 15753052 <GO>}

Interesting. And related to that point, what are the sign posts we should look at to say oh wow, I see where the design are coming from. Is it going to be just more auto shows and more CESs to come?

Chris Evenden {BIO 18934997 <GO>}

Yes. We've got design wins that people might not even announce this year because it's (inaudible) design for so long. Our two largest customers right now are Volkswagen Audi Group and BMW. So we are in the whole range of Audi cars I think now from A3 on up. We in the Golf, Volkswagen Golf. We always have an interesting debate with our marketing department because whenever they produce slides, they like to put Tesla and Lamborghini on our automotive slides. But I would like to put Golf on our automotive slides.

We are in BMW i3. We are going to be in the i8 when that is launched. We are in the 3, 5 and 7. We are in the Tesla obviously. We're in a whole bunch of other -- we are in Skoda actually. So if there are Europeans in the room, they'll actually recognize the brand. Well Skoda has come a long way. But my point being is we are not just in Bentley and Lamborghini. It goes the full gamut. Then we have another couple of major automotive manufactures that we haven't announced at all yet. So they are part of that $2 billion pipeline as well.

James Schneider {BIO 15753052 <GO>}

Great. I want to shift to the core GPU business for a second. Maxwell is out there as the product you said you were going to launch this year. And there's a lot of speculation in the trade press about that being kind of relatively imminent. That's the 20 nanometer product.

Chris Evenden {BIO 18934997 <GO>}

There's no personal growth reading those forms, you know that, right?

James Schneider {BIO 15753052 <GO>}

I know firsthand. But can you help us understand? I understand you don't want to preannounce any products today. But understand (spagie) with macro, when it comes and whether we should expect this to be kind of a traditional Nvidia launch where it kind of starts at the high end and it waterfalls down to the (inaudible)?

Chris Evenden {BIO 18934997 <GO>}

There's so much I want to say and absolutely nothing I can say. We'll talk about -- we never talk about products before they are announced. You have -- and the GPU market is a very, very competitive market. And the products are quite perishable. Typically you have a six-month like cycle and then you're done and then you move onto the next one. So you want to maximize every hour of revenue generating ability that product has. So we literally, when we launch them, they're almost always actually available in sale that day. And you don't tip your hand at all for the competitor before you do it. So you'll find out about Maxwell when it matters, when people can buy it. It doesn't matter what I say about Maxwell right now because no one can buy it anyway. So what matters is how competitive will Maxwell be when it launches. And obviously I can make some empty statements about how great I feel it's going to be. But you'll see when the reviews go live.

James Schneider {BIO 15753052 <GO>}

I do want to ask about the notebook business, because that's still a material chunk of business for you. You talked about the dynamic. But I want to ask you about the market share because I think now is the time when you certainly have visibility as to what happened for back-to-school, etc. So can you talk about directionally how you feel about your notebook OEM share position as we head into the end of this year?

Chris Evenden {BIO 18934997 <GO>}

So I do have visibility on that. I'm not sure I want to share too much about it. The OEM -- because the other thing that introduces uncertainty in that is exactly when OEMs refresh their lines. And so if they are all in the same cadence -- if they change their cadence, then all my numbers will be off. So I probably shouldn't talk about that with you because I don't actually know for certain right now. I know which design slots I'm in and I know when they're scheduled to start shipping. And I know which designs I didn't win. And I know when they're scheduled to start shipping. But I don't know how that will translate into market share.

Then like I said, market share is data, that's great. But on the other hand, you've got to be careful because it's very swayed by the large numbers of low-value units with low profits as well. So you can find yourself -- in fact, we were in Q3 of last year, we actually, according to the Mercury numbers, our market share went down. But our dollar share clearly went up. So you have to be careful about -- the data is good. And I don't want to steer anyone away from using data ever. But on the other hand I want to caution people about reading too much into it because it can be misleading in terms of market share for those units. And those units are -- you can have a GPU that's $12 and is making 25% gross margins at the low end and you can ship 1 million of those and hardly shift profit dollars from one company to the other.

James Schneider {BIO 15753052 <GO>}

Yes. Switching to professional for a second then --

Chris Evenden {BIO 18934997 <GO>}

Now we are talking profit dollars.

James Schneider {BIO 15753052 <GO>}

Yes, exactly. Let's go from one extreme to the other. Quadro was actually pretty good for you last year, I think. And I guess part of that --

Chris Evenden {BIO 18934997 <GO>}

Best year ever actually for Quadro last year. Actually, it's a record. Yes.

James Schneider {BIO 15753052 <GO>}

So I think part of that was the tablet refresh. Part of that arguably was just kind of the customer set coming back, the automotive, industrial --

Chris Evenden {BIO 18934997 <GO>}

Yes.

James Schneider {BIO 15753052 <GO>}

-- (multiple speakers) use this, because that is the cyclical balance. So big growth there for Quadro. So as we head into 2014, how should we think about does that normalize, or do you see continued headwinds in kind of the overall market? And what's the impact that we should think about in terms of the product launch not anniversarying or whatever it is?

Chris Evenden {BIO 18934997 <GO>}

RBC tells us we have 81% market share, unit share in Workstation. And we believe we have over 90% dollar share. What that means is the market movements are more significant than share gains or losses in that. Now, we have a bunch of initiatives in place to grow the market, intended to grow the market. But nevertheless the dominant term in that equation, if you like, is where the market actually goes. And so how can I use market data to predict where Quadro goes. Quadro, 80% of Quadro revenues are CAD-based. So manufacturing GDP is generally a good -- as good as it gets in terms of indicators of the way the business going to go. So I would look to that. If you look at where manufacturing is going in the next 12 months, where do we think that is going to be strong, that would tell you something about our Quadro market. So I think it had been weak for some time and I think it sort of recovered to a more rational level last year. So I don't see it normalizing back down again particularly. But at the same time, I wouldn't want to guide you towards like 20% growth or something. It's (multiple speakers)

James Schneider {BIO 15753052 <GO>}

It probably doesn't grow like it did last year. But it's growth.

Chris Evenden {BIO 18934997 <GO>}

Yes. Thank you. You should be a press room communicator.

James Schneider {BIO 15753052 <GO>}

I guess I want to ask about Tesla, because that's an area where I think it's hard for investors to kind of see like what's really going on under the hood kind of buried in the P&L that you report. We also know that it's lumpy, some of it's tied to kind of supercomputing or very specific big customer builds. And some of it is more OEM based. So how should we think about the Tesla business, how big was it last year and kind of directionally what's going to drive the growth in 2014?

Chris Evenden {BIO 18934997 <GO>}

So we don't break it out separately. It grew a lot last year. It grew nearly 40% year-on-year into last year. The thing that really excites me about the Tesla business, actually I love the Tesla business. It's really broken out I think in a sense that for a couple of years, it was puttering along at sort of level of $25 million a quarter or thereabouts.

And it's sort of puzzling to me because it was clearly -- you go to an HPC show and there would be so much enthusiasm and so much passion and you'd see Tesla at every booth, whether was IBM's booth or Supermicro's booth or Cray's booth, it was there. And people were using it and the engineer -- the scientists and engineers in their poster session would have all these incredible applications for Tesla. And it was clearly (inaudible) and yet $25 million, $25 million, $25 million every quarter. And now we've really broken out of that. And I think the reason we've broken out of that is because two things, actually. One, we support the critical number of codes because there is work that has to be done in taking a code from a regular architecture PC to a parallel architecture like Tesla. And two, our channel now in terms of Supermicro, Dell, HP, IBM, Cray, all those guys. So whereas in the past, a year ago or 18 months ago, our Tesla team would have had to have gone in person to the engineering firm and evangelize the product. And evangelize first and then sold and then shipped, right?

Now we are at a point where there could be a guy, a researcher at Johnson & Johnson looking into protein interaction. And he knows he needs the molecular dynamics, he knows that Tesla accelerated molecular dynamics code. He knows he can get a Tesla server from IBM. So he just dials up the IBM salesman and it gets delivered on Tuesday. It's a completely different sale. And that's made a big difference.

I think, in retrospect, that $25 million represented what our team was capable of personally supporting directly. And now we've got all these other people supporting us. And the announcement we made last quarter with IBM -- and the GM of our business thinks it's the most significant announcement we've made all year in the sense that now you've got all of IBM's salespeople enthusiastically selling Tesla into all their accounts, which is a pretty big deal. IBM is responsible for nearly a third of the supercomputing installations worldwide. So that's pretty important. But also, more interestingly, they are looking at applying GPU acceleration to all of their enterprise apps as well. So this is a whole new market for us. So there's no -- this is all a very long way of saying there's no reason not to believe that a strong growth at Tesla would not continue. I would expect that strong growth to continue.

James Schneider {BIO 15753052 <GO>}

Got it. I'd be remiss not to ask any financial questions. So I'll ask about gross margins first and maybe talk about capital return quickly. Gross margins, you've done a great job of expanding gross margins, part of that -- over the past several years. Part of that has been the Intel licensing agreement, which is all gross margin of course. But then part of it has also been your foundry agreements allowed you to really kind of basically take ownership of the yields on it.

Chris Evenden {BIO 18934997 <GO>}

I think it's mostly mix actually, because if you think about how much we expanded gross margins, before the previous ramp, our record gross margin was 46.3%. And that was at a time that, frankly, that ATI hadn't produced a decent graphics card for three years. So we had the market to ourselves. Now we are at mid-50s% basically.

We were a bit lower last quarter but we've guided to recover slightly this quarter. So now we are in the mid-50s%. And that 10 points of margin didn't come from just Intel and better negotiation with our sole supplier for semiconductors. It's not an easy negotiation, as you might imagine. It came from mix. We developed the Quadro business. We developed the Tesla business. The gaming business is becoming more and more profitable as well. That GPU business is becoming more and more affordable. So there's a whole bunch of things that have pushed the margins up 1000 basis points in a couple of years.

James Schneider {BIO 15753052 <GO>}

So from here, it sounds like you wouldn't expect any big structural kind of underlying changes to drive it. It would be mix, as you said --

Chris Evenden {BIO 18934997 <GO>}

It's mix, right.

James Schneider {BIO 15753052 <GO>}

(multiple speakers) gets more profitable and professional mix grows and --

Chris Evenden {BIO 18934997 <GO>}

Yes, exactly. The OEM business declining this year is a tailwind for gross margins. Tesla growing at the tail end of margins. We will see what good it does. I don't know what good it does. And we'll see how Tegra does as well.

James Schneider {BIO 15753052 <GO>}

Yes, capital returns. You've done a great job there. You've taken on $1.5 billion of (inaudible) in the form of convert. Presumably that's going to be mostly if not all share buyback.

Chris Evenden {BIO 18934997 <GO>}

Yes.

James Schneider {BIO 15753052 <GO>}

So how should we think about your appetite for doing even more beyond this? Because clearly there is some firepower in the balance sheet.

Chris Evenden {BIO 18934997 <GO>}

Yes. So that $1.5 billion gives us flexibility (inaudible) as well. So we said we would return $1 billion this year. Dividends account for just, rough numbers, $160 million of

that, maybe $180 million of that, something in that range. And the rest will be share repurchases at some point during this year, yes.

James Schneider {BIO 15753052 <GO>}

And your appetite for doing more even than that?

Chris Evenden {BIO 18934997 <GO>}

It's still there. It's still there. Like we said, there will be some left over at the end of the year. And so let's reconsider, let's see where we are then.

James Schneider {BIO 15753052 <GO>}

Great. With that, I think we are out of time. Thanks, Chris, for being with us.