



NVIDIA's Gaming Business Could Get a Boost This Fall

Description

The heat is on in the market for gaming graphics cards. The two dominant graphics providers are **NVIDIA** ([NASDAQ: NVDA](#)) and **Advanced Micro Devices** ([NASDAQ: AMD](#)), and both companies have released flashy new graphics processors over the last year. NVIDIA has been touting its Turing RTX graphics processors — the first graphics processing unit (GPU) to combine ray tracing and deep learning technology to deliver more realistic lighting and shadow effects.

Meanwhile, AMD has put its research dollars to work in smaller, faster 7-nanometer chips with its RX Radeon 5000 GPU family. Team Red claims to deliver competitive performance at a lower price than NVIDIA's RTX series.

NVIDIA has led AMD in market share since 2005, but this fall promises to be one of the most competitive seasons for [the GPU market](#) in recent memory. Despite the heightened pressure, NVIDIA should see growth in its gaming business — its largest — in the next few quarters. Here's why.

Support for ray tracing continues to build

Currently, NVIDIA's RTX graphics cards are the only chips that feature ray-tracing capability. This is an enormous advantage for Team Green in the short term. Ray tracing has been adopted by every major game engine that is used to make video games. Because of that, we're starting to see an avalanche of support coming from game companies that are designing games optimized for NVIDIA's RTX GPUs.

NVIDIA got an enormous endorsement when **Microsoft's** *Minecraft* — one of the best-selling games of all time — released a new version featuring support for ray tracing. But that's just the tip of the iceberg. The coming months will see a wave of big-budget titles, including **Activision Blizzard's** *Call of Duty: Modern Warfare*, **Ubisoft Entertainment's** *Watch Dogs: Legion*, and Bethesda's *Wolfenstein: Youngblood* — all optimized for NVIDIA's RTX cards.

Looking further out, CD Projekt Red's *Cyberpunk 2077* will also be optimized for RTX and should be a hit when it releases in the spring of 2020. *Cyberpunk 2077* is anticipated to be one of the best games of the past decade, which should serve as a natural incentive for gamers to buy an RTX GPU.

New games are driving upgrades

So far, demand appears to be healthy for NVIDIA's new generation of gaming GPUs. The company reported during the last conference call in August that [demand has been strong for RTX SUPER cards](#), a newer version of the original RTX cards NVIDIA launched last year. Gaming revenue [increased by 24% sequentially last quarter](#), a significant acceleration over the previous quarter's growth rate.

During the company's fiscal second-quarter conference call, CEO Jensen Huang said, "RTX adoption is faster than Pascal's adoption," which is quite a statement. Pascal was the previous generation of NVIDIA's gaming cards, which launched in 2016 and was an enormous success for the company. NVIDIA's gaming revenue nearly doubled between fiscal 2016 and fiscal 2018 (which ended in January).

The gaming segment should post solid year-over-year gains in revenue in the next few quarters. The company will be facing an easy year-over-year comparison in the short term as strong demand for RTX GPUs laps the weak sales of gaming cards in the second half of 2018.

The company's guidance calls for a sequential improvement in gross margin next quarter, which management attributed to a favorable sales mix shift in the gaming business. This implies strong demand for high-end RTX graphics cards, which carry higher margins than lower-priced cards.

One more thing to watch

Investors should watch the demand for gaming notebooks. This could play a significant role in boosting NVIDIA's gaming business not just this fall but over the next few years.

Gaming notebooks are one of the fastest-growing platforms in the gaming industry. NVIDIA doesn't break out sales of GPUs for gaming notebooks, but in the fiscal third quarter of last year, gaming notebook sales jumped 50% year over year in China — one of the largest gaming markets in the world. Keep in mind that this was during a period when NVIDIA was reporting weak sales overall in its gaming business due to oversupply in the marketplace.

NVIDIA's Max-Q technology combined with the power of RTX is offering gamers the ability to play games at the best graphics settings in a form factor that is thin and lightweight, and it's proving a popular alternative to gaming on a stationary desktop PC. Management expects gaming notebook sales to remain strong through 2020.

The next few quarters will set the tone for next year. A rejuvenated gaming business would likely see NVIDIA return to growth on the top and bottom lines in fiscal 2021. While revenue and earnings are expected to be down this year, given the slow start to the year, analysts currently expect NVIDIA to grow revenue and earnings per share by 19.8% and 31.5%, respectively, next year.

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