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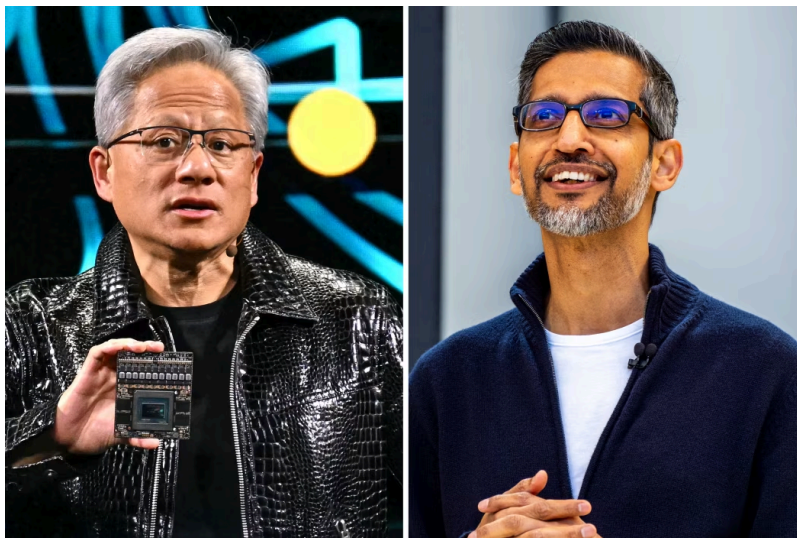
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Nvidia's Fat Margins Are Google and AMD's Opportunity

Nvidia's leading position in AI chips is secure, but its profit margins look vulnerable

By [Dan Gallagher](#) [Follow](#)

Dec. 3, 2025 5:30 am ET



Nvidia Chief Executive Jensen Huang and Google CEO Sundar Pichai. PATRICK T. FALLON/AFP/GETTY IMAGES; CAMILLE COHEN/AFP/GETTY IMAGES

The AI revolution has created a unique and high-quality problem for [Nvidia](#) NVDA **-3.71%** ▼ : The chip maker makes too much money.

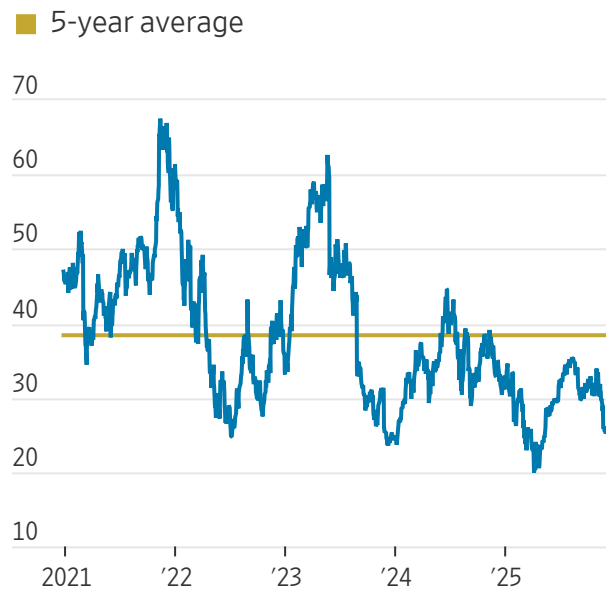
Nvidia [has fallen under scrutiny](#) over the past month as investors have come to worry about the sustainability of blowout artificial-intelligence spending. But another fear surfaced last week with reports that Google is looking [to enter the AI chip market](#) by selling the chip it designed in-house, known as a tensor processing unit or TPU, for its own computing needs.

Nvidia's stock price has picked up some ground this week, but the shares are still down 12% since the company peaked at a [\\$5 trillion market cap](#) in late October. The Nasdaq composite has lost about 2% in that same time.

The recent decline has made the world's most valuable company look cheap. Nvidia's stock now trades around 26 times projected earnings for the next four quarters—close to its lowest multiple over the past five years, according to FactSet data. But that ratio is based on earnings expected over the next year that could come under pressure if stronger competition forces Nvidia to lower its prices.

Sold Off

Nvidia's share price as a multiple of projected earnings, past five years



Source: FactSet

A haircut to earnings would still leave Nvidia [more profitable](#) than most other chip companies, but the stock wouldn't be quite the bargain it seems to be, despite the company's still-commanding lead in the lucrative AI-chip market.

How lucrative? Nvidia has generated a little over \$110 billion in operating income over the last four quarters. That equates to about 59 cents of operating profit for every dollar of revenue, far above what any other chip company on the PHLX Semiconductor Index commanded over the same period, according to data from S&P Global Market Intelligence. [TSMC](#)—the

Taiwan manufacturing powerhouse that actually makes most of Nvidia's chips—produced an operating margin of just under 50% for the same period, while the average for companies on the index is around 25%.

Nvidia's gross margins, which reflect the direct costs of producing a company's products, now stand at 70% on an annual basis. That compares with an average of around 62% for the five-year period before sales exploded in mid-2023 from AI demand. Nvidia then credited the gross margin jump to "a significant amount of software and complexity" in its data-center products. Fabless chip companies [Qualcomm](#), [Advanced Micro Devices](#) AMD -4.96% ▼ and [Marvell](#), which also outsource their manufacturing, currently command annual gross margins in the low 50% range, according to data from S&P Global Market Intelligence.

AMD's margins are particularly notable given that the company is gearing up for a [major challenge to Nvidia's dominance](#) in the AI-computing market. The MI450 chips that the company plans to start shipping next year already have landed a major customer in OpenAI, and AMD Chief Executive Lisa Su told analysts last month that more major customers are coming.

Neither Nvidia nor AMD has publicly disclosed prices for their AI chips, which are generally customized for each major customer, making direct comparisons difficult. But their sharply different profitability levels gives AMD the advantage of being able to underprice Nvidia and still boost its margins. The company, in fact, has publicly committed to surpassing 35% in annual pro forma operating margins over the next three to five years, compared with 22% now. AMD's pro forma margins exclude the cost of stock-based compensation and other charges.

Now, competition from Google adds a new wrinkle, as the search giant already has a [highly profitable advertising business](#) that can support an ambitious new venture like directly entering the AI-chip market.

Parent company [Alphabet's](#) GOOGL **-1.91%** ▼ operating cash flow of \$151.4 billion over the past four quarters is actually the highest on the S&P 500. And landing a customer like Facebook-parent [Meta Platforms](#) META **0.02%** ▲ would be a [big win](#) for Google's TPU efforts. Meta is a major Nvidia customer but has a strong need to secure as many AI chips as it can given Mark Zuckerberg's ambitious [goal of developing "superintelligence"](#) before rivals like OpenAI get there.

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Analysts aren't panicking about Nvidia yet. "In the near term, Meta using TPUs doesn't materially affect our viewpoint on Nvidia despite the narrative headwind it creates," [Morgan Stanley's](#) Joe Moore wrote in a note to clients last week. Google itself is still a major Nvidia customer and frequently touts its access to the company's most advanced products. Moore estimates Google now spends about \$20 billion a year on Nvidia's chips.

But Wall Street is still keenly focused on Nvidia maintaining gross margins in the 70% range—even with sharply rising costs for key components like memory. And Google's latest chip advances, plus new offerings from AMD and [Amazon's](#) AMZN **-0.82%** ▼ latest [Trainium 3 chip](#) announced on Tuesday, show competition keeps picking up for a key market that Nvidia has long dominated. Nvidia's ability to maintain pricing power—and its high margins—will only get harder from here.

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Appeared in the December 4, 2025, print edition as 'Nvidia's Fat Margins Are Rivals' Opening'.

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