intel

1997 Annual Report

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a site especially for investors

A consistent approach

The challenges of 1997 confirm that our long-term strategy for growth and success continues to serve us well. We will continue to drive new technology, serve global markets, increase consumer preference for the Intel brand and work to deliver excellent financial results to our stockholders. This strategy will serve as our road map into the next decade.

Technology

Intel is committed to continually improving the computing experience for PC users by delivering faster, more powerful processors. The complexity and performance of our microprocessors have increased exponentially over the years, making possible dramatic improvements in all kinds of software. From 3D financial charts to lifelike video animation, the software content available on PCs today taps the increased processing power of Intel microprocessors to deliver an exciting, media-rich computing experience.

Global markets

In many areas around the world, PCs are not yet as common as they are in the U.S. and Europe. Intel will continue to focus on emerging computer markets worldwide, with initiatives such as our branding programs, which help stimulate demand and educate potential PC users about the benefits of Intel architecture-based PCs. We are also working to supply appropriate products in emerging markets, so that consumers and businesses worldwide can take advantage of the power of today's PCs.

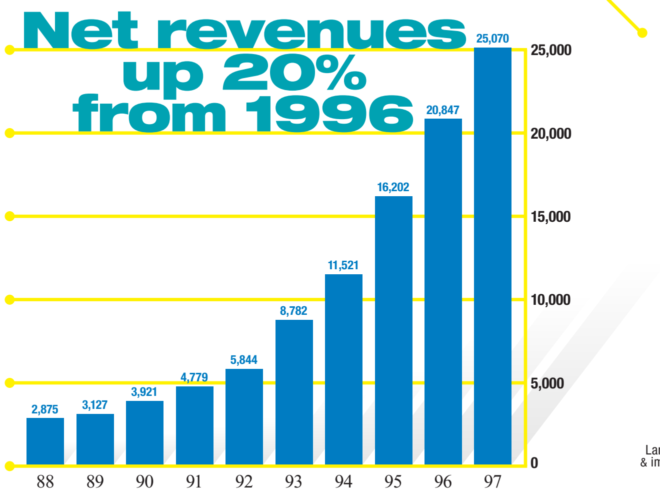
Branding

The Intel brand continues to be one of our most important assets. In 1997, the journal *Financial World*§ ranked Intel number 8 among worldwide brands, placing us in the company of household names like Coca-Cola, McDonald's and Sony. Around the world, our branding programs have helped make people aware of the power and excitement they get when their PC has an Intel processor inside.

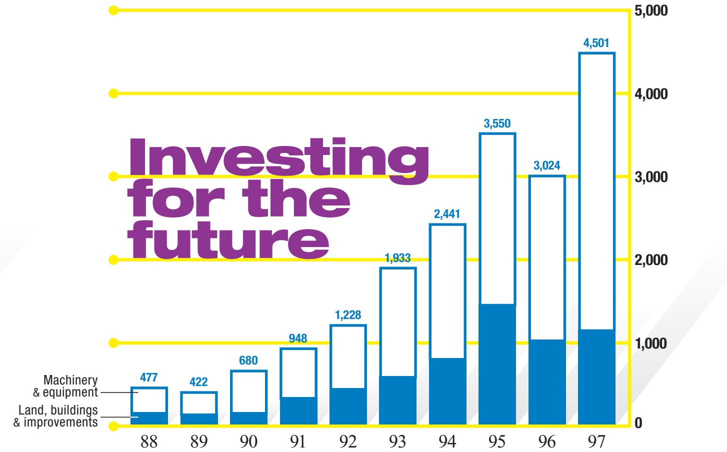
Results

We are proud that Intel has provided excellent, long-term returns to investors. The fiscal year-end closing price of our stock has risen at a compound annual growth rate of 42% over the last 10 years. While we can never guarantee future returns, we are optimistic that our fundamental products, capabilities and strategies are excellent and that our financial strength remains a competitive advantage. We will continue to concentrate on initiatives to keep our long-term earnings growth ahead of the growth rate of the main market segments in which we participate.

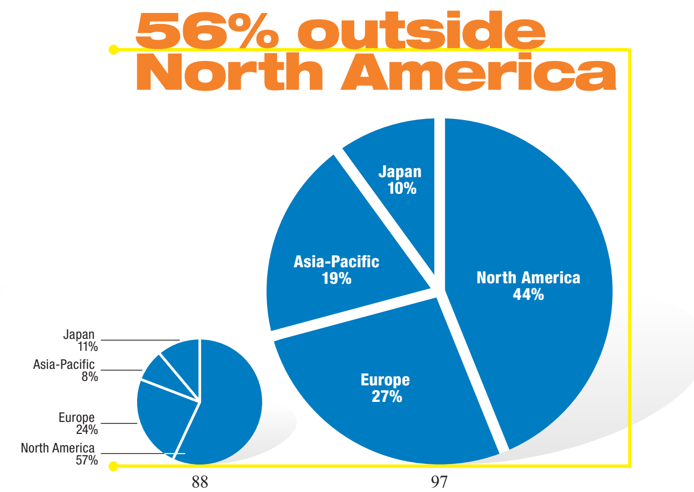
INTEL CORPORATION 1997



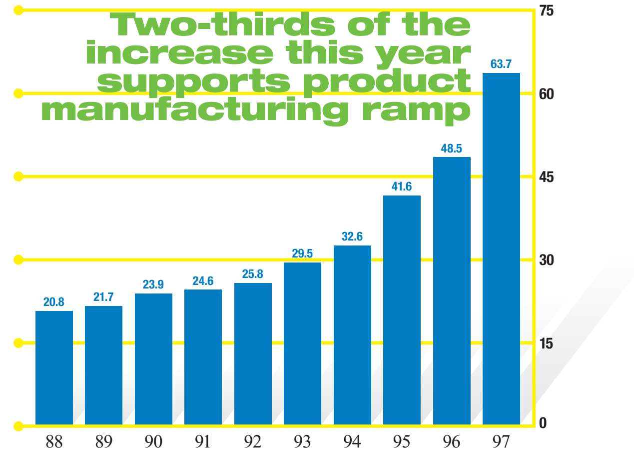
Net revenues
(Dollars in millions)



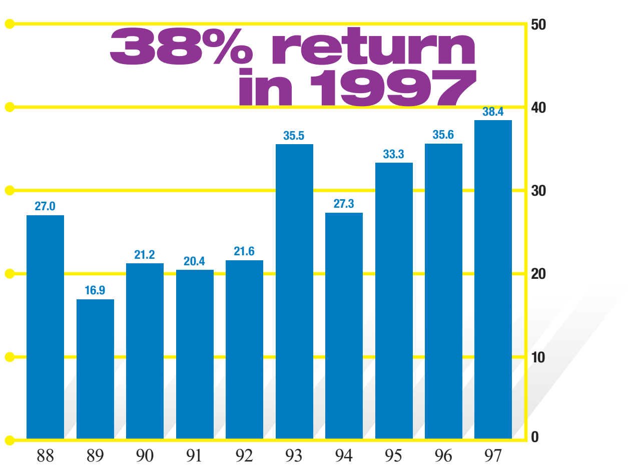
Capital additions to property, plant and equipment
(Dollars in millions)



Geographic breakdown of revenues
(Percent)



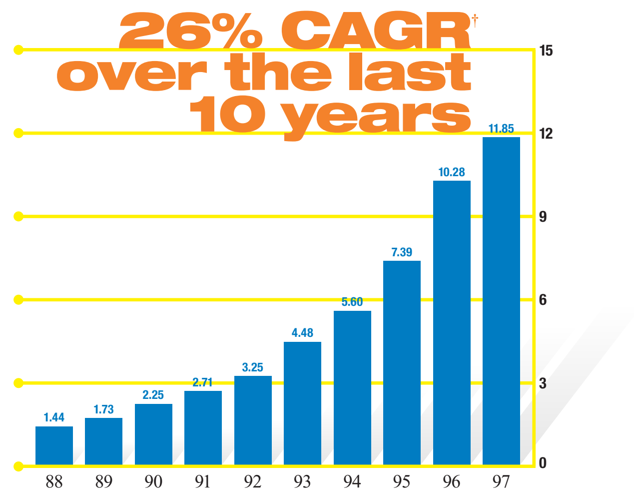
Employees at year-end
(In thousands)



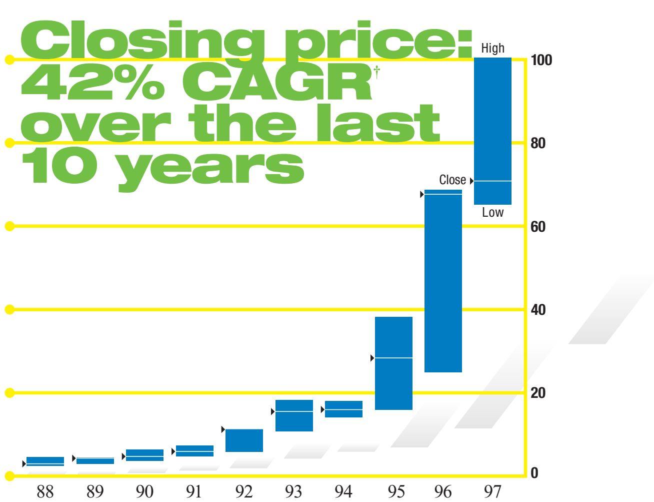
Return on average stockholders' equity
(Percent)

Intel 10-year facts & figures

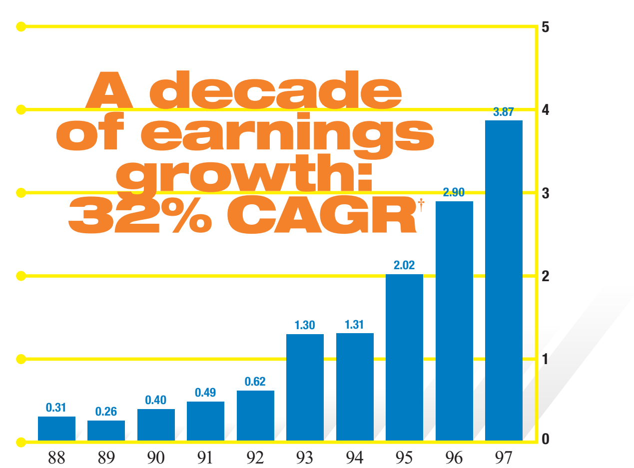
Intel and its stockholders have experienced a remarkable decade of successful financial performance and achievements. We've built stockholder value by implementing a long-term vision, bringing excellent products to market and executing our business strategy well. Amid challenges and changing economies, Intel continues to excel.



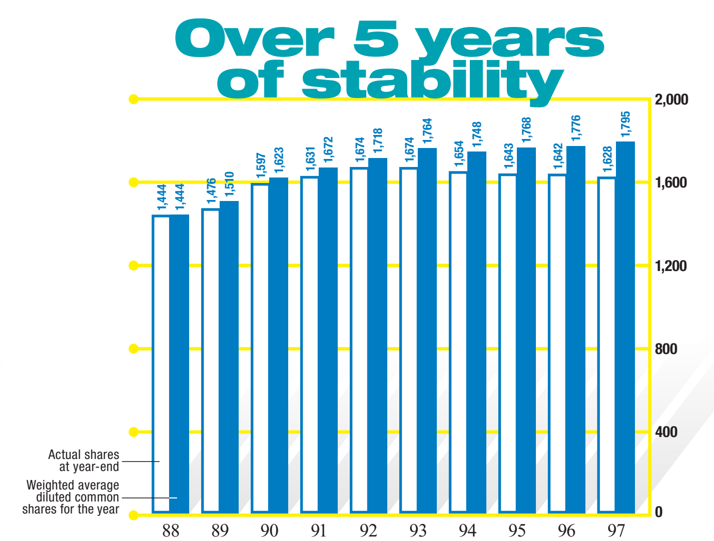
Book value per share at year-end
(Dollars, adjusted for stock splits)



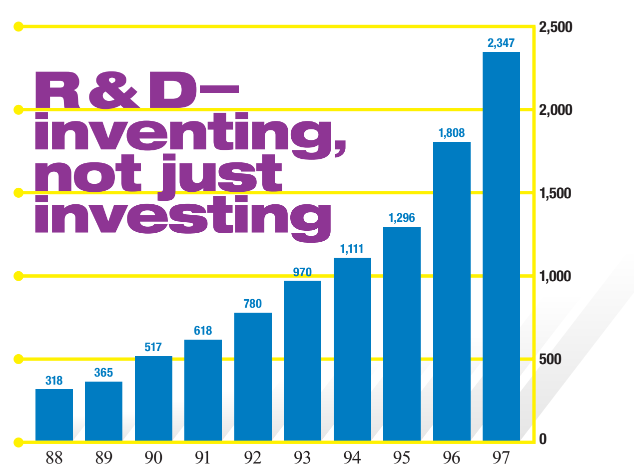
Stock price trading ranges by fiscal year
(Dollars, adjusted for stock splits)



Diluted earnings per share
(Dollars, adjusted for stock splits)



Common shares outstanding
(In millions, adjusted for stock splits)

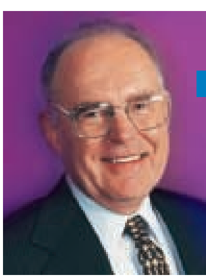


Research and development
(Dollars in millions)

Past performance does not guarantee future results. Share and per share amounts shown have been adjusted for stock splits through 1997.

†*Compound annual growth rate.*

the year delivered record financial results



To our stockholders

We achieved record revenues in 1997, up 20% over 1996, making this our 11th consecutive year of record revenues. Net income was up 35% to a record $6.9 billion.

We introduced two major new microprocessors in 1997, essentially replacing our previous product lines. In January 1997, we introduced the Pentium® processor with MMX™ technology, the first chip to include Intel's new technology for improved performance on media-rich applications. In May 1997, we introduced the Pentium® II processor, our most powerful processor to date. The Pentium II processor has brought new levels of visual computing to the desktop for consumers as well as small and large businesses. It also provides the performance to drive robust applications running on powerful workstations and servers.

Our investment in the future continued in 1997; we spent $2.3 billion on R&D and $4.5 billion on capital expenditures. Our commitment to R&D creates future generations of products and the manufacturing processes we use to make them, while our capital expenditures ensure the availability of state-of-the-art factories that allow us to deliver high-volume, high-performance microprocessors efficiently.

Throughout 1997, our factories responded superbly to the two major product transitions, ramping new semiconductor processing and packaging technologies at an unprecedented rate. More than 90% of the microprocessors shipped in the fourth quarter were introduced in the first five months of 1997.

In the computing market, the growth of the "basic PC" segment—systems costing less than $1,000—and the rapid growth of standard high-volume servers based on our microprocessors led to an adaptation of our product lineup and development approach. We implemented a plan to deliver a wide range of processors focused on different computing market segments. In addition, we realigned our management and organizational structure to focus on separate market segments, enabling us to take maximum advantage of the increasingly diverse computing market.

The geographic diversity of Intel's business helped us weather economic problems in various parts of the world. Sluggish demand in Europe in the first part of the year, currency crises in Southeast Asia late in the year and a prolonged economic slowdown in Japan all challenged us. Fortunately, Europe had a strong second-half comeback and the U.S. and China remained healthy.

Despite these challenges, we are more excited than ever about the future of computing and our role in it. With hundreds of millions of connected PCs around the world, people are demanding more and more from their PCs—whether they use them to market new products or to explore online encyclopedias for a school project, whether they link remote workgroups or share family news as it happens, whether they conduct millions of corporate transactions a day or download the family banking statement. Such activities all require powerful microprocessors—the "brains" of PCs and the core of our business.

Our initiatives will focus on all major segments of the computing market. We will continue to deliver high-performance microprocessors that drive high-end PCs and workstations at competitive prices and will still offer powerful microprocessors for the basic PC market segment. Servers based on Intel microprocessors will provide the storage and connection points to corporate networks and the booming Internet. Our networking and communications products will deliver easier manageability and greater bandwidth for a richer experience on the network. And we will continue to build the Intel brand preference that has made Intel a household name around the world.

Beyond our own initiatives, we continue to look for ways to help the computing industry deliver "more uses to more users." We actively invest in companies that have the potential to expand computing and telecommunications capabilities. Working with software developers, we encourage new applications that take advantage of improvements in microprocessor performance and make computing more satisfying for PC users.

We believe our strategy will capture growth in our market segments over the coming years. Our success, as always, rides on our corporate culture devoted to excellence, the hard work of our employees and our commitment to stockholder value. We look forward to the challenges and opportunities of 1998.

Gordon E. Moore
Chairman Emeritus

A. S. Grove

Andrew S. Grove
Chairman and CEO

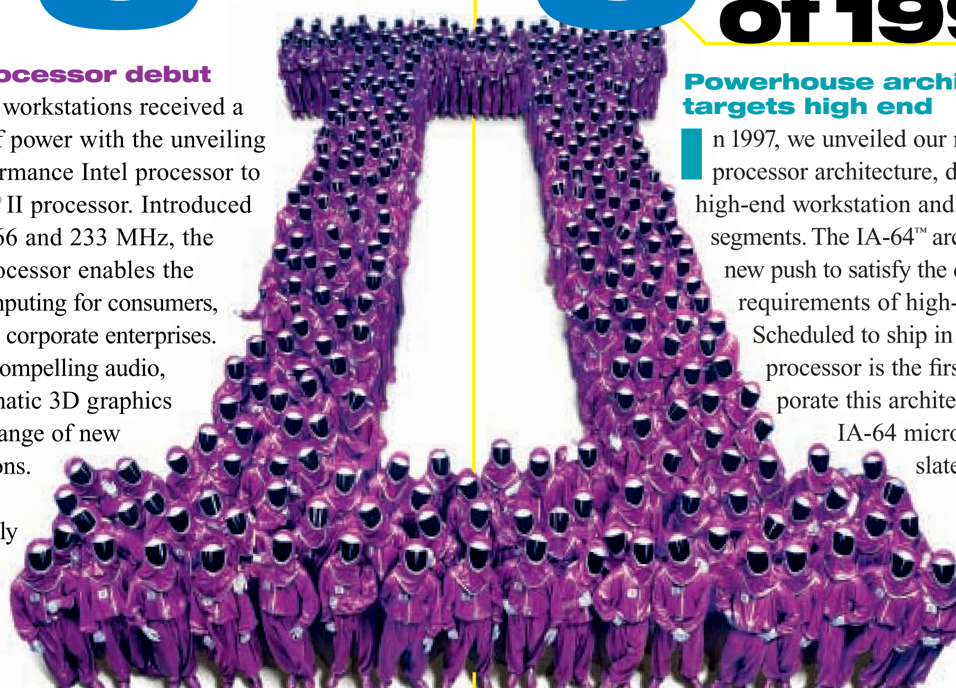
Craig R. Barrett

Craig R. Barrett
President and COO

highlights of 1997

Intel MMX™ technology: media star

The year opened big for Intel with the introduction of our Pentium® processor with MMX™ technology in January. The launch was accompanied by a massive advertising campaign targeting consumers and marked the first time Intel advertised during the Super Bowl. The campaign unveiled our now-famous BunnyPeople™ characters (the "bunny suits" they wear are flashy versions of the head-to-toe clean suits worn by technicians at microprocessor fabrication facilities) and emphasized how powerful, media-rich MMX technology can make using a PC more fun. Please check the back cover to get your BunnyPeople character sticker with our Investor Relations Web address (www.intc.com).



Pentium® II processor debut

Desktops and workstations received a new burst of power with the unveiling of the highest performance Intel processor to date—the Pentium® II processor. Introduced at speeds of 300, 266 and 233 MHz, the Pentium II microprocessor enables the growth of visual computing for consumers, small businesses and corporate enterprises. It also brings more compelling audio, fluid video and dramatic 3D graphics to the desktop in a range of new interactive applications.

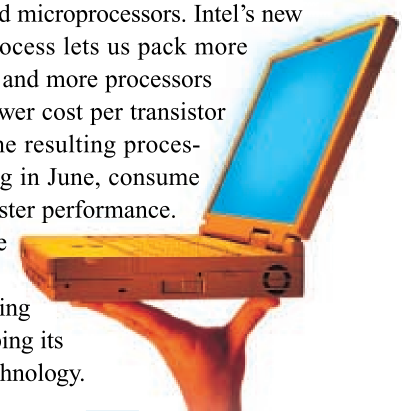
The Pentium II processor dramatically entered the computing scene. By the end of 1997, it represented about 25% of our microprocessor production. While PCs using the Intel486™ microprocessor took over four years to reach a price point of $2,500, PCs based on the Pentium II processor were available at this price about three months after the microprocessor's introduction in May 1997.

In 1998, we plan to introduce Pentium II processors at speeds of up to 450 MHz. New software titles are being designed to take advantage of this additional power. Two exciting examples are *Red Line Racer** by Criterion Studios and *G.Police** by Psygnosis, Ltd. Both programs have extremely realistic 3D graphics and action-packed scenes providing high levels of interactivity and entertainment for the user.

Manufacturing under a microscope

Think small—the width of a human hair, perhaps. Then consider that a human hair is 400 times the width of the circuits on Intel's most advanced microprocessors. Intel's new 0.25-micron manufacturing process lets us pack more transistors onto each processor and more processors onto each silicon wafer, at a lower cost per transistor than previous technologies. The resulting processors, which first began shipping in June, consume less power and deliver much faster performance.

Intel was the first high-volume manufacturer of processors to use the 0.25-micron manufacturing process and is currently developing its next-generation 0.18-micron technology.



Powerhouse architecture targets high end

In 1997, we unveiled our new 64-bit microprocessor architecture, designed for the high-end workstation and server market segments. The IA-64™ architecture marks a new push to satisfy the diverse computing requirements of high-end systems. Scheduled to ship in 1999, the Merced™ processor is the first product to incorporate this architecture; our second IA-64 microprocessor is slated for 2001.

The Merced processor will deliver additional power for advanced workstation and server systems while maintaining compatibility with current 32-bit industry-standard operating systems and applications. This combination is expected to enable businesses to improve the performance of their enterprise solutions while reducing the cost per user. Many of our customers plan to build systems based on the IA-64 architecture.

Index to financial information

Consolidated statements of income

Three years ended December 27, 1997

(In millions—except per share amounts)	*1997*	*1996*	*1995*
Net revenues	**$ 25,070**	**$ 20,847**	**$ 16,202**
Cost of sales	9,945	9,164	7,811
Research and development	2,347	1,808	1,296
Marketing, general and administrative	2,891	2,322	1,843
Operating costs and expenses	15,183	13,294	10,950
Operating income	**9,887**	**7,553**	**5,252**
Interest expense	(27)	(25)	(29)
Interest income and other, net	799	406	415
Income before taxes	**10,659**	**7,934**	**5,638**
Provision for taxes	3,714	2,777	2,072
Net income	**$ 6,945**	**$ 5,157**	**$ 3,566**
Basic earnings per common share	**$ 4.25**	**$ 3.13**	**$ 2.16**
Diluted earnings per common share	**$ 3.87**	**$ 2.90**	**$ 2.02**
Weighted average common shares outstanding	**1,635**	**1,645**	**1,650**
Dilutive effect of:			
Employee stock options	102	94	96
1998 Step-Up Warrants	58	37	22
Weighted average common shares outstanding, assuming dilution	**1,795**	**1,776**	**1,768**

See accompanying notes.

Consolidated balance sheets

December 27, 1997 and December 28, 1996

(In millions—except per share amounts)	*1997*	*1996*
Assets		
Current assets:		
Cash and cash equivalents	$ 4,102	$ 4,165
Short-term investments	5,630	3,742
Trading assets	195	87
Accounts receivable, net of allowance for doubtful accounts of $65 ($68 in 1996)	3,438	3,723
Inventories	1,697	1,293
Deferred tax assets	676	570
Other current assets	129	104
Total current assets	15,867	13,684
Property, plant and equipment:		
Land and buildings	5,113	4,372
Machinery and equipment	10,577	8,729
Construction in progress	2,437	1,161
	18,127	14,262
Less accumulated depreciation	7,461	5,775
Property, plant and equipment, net	10,666	8,487
Long-term investments	1,839	1,353
Other assets	508	211
Total assets	$ 28,880	$ 23,735
Liabilities and stockholders' equity		
Current liabilities:		
Short-term debt	$ 212	$ 389
Long-term debt redeemable within one year	110	—
Accounts payable	1,407	969
Accrued compensation and benefits	1,268	1,128
Deferred income on shipments to distributors	516	474
Accrued advertising	500	410
Other accrued liabilities	842	507
Income taxes payable	1,165	986
Total current liabilities	6,020	4,863
Long-term debt	448	728
Deferred tax liabilities	1,076	997
Put warrants	2,041	275
Commitments and contingencies		
Stockholders' equity:		
Preferred Stock, $.001 par value, 50 shares authorized; none issued	—	—
Common Stock, $.001 par value, 4,500 shares authorized; 1,628 issued and outstanding (1,642 in 1996) and capital in excess of par value	3,311	2,897
Retained earnings	15,984	13,975
Total stockholders' equity	19,295	16,872
Total liabilities and stockholders' equity	$ 28,880	$ 23,735

See accompanying notes.

Consolidated statements of cash flows

Three years ended December 27, 1997
(In millions)

	1997	1996	1995
Cash and cash equivalents, beginning of year	**$ 4,165**	**$ 1,463**	**$ 1,180**
Cash flows provided by (used for) operating activities:			
Net income	6,945	5,157	3,566
Adjustments to reconcile net income to net cash provided by (used for) operating activities:			
Depreciation	2,192	1,888	1,371
Net loss on retirements of property, plant and equipment	130	120	75
Amortization of debt discount	—	—	8
Deferred taxes	6	179	346
Changes in assets and liabilities:			
Accounts receivable	285	(607)	(1,138)
Inventories	(404)	711	(835)
Accounts payable	438	105	289
Accrued compensation and benefits	140	370	170
Income taxes payable	179	185	372
Tax benefit from employee stock plans	224	196	116
Other assets and liabilities	(127)	439	(324)
Total adjustments	3,063	3,586	450
Net cash provided by operating activities	**10,008**	**8,743**	**4,016**
Cash flows provided by (used for) investing activities:			
Additions to property, plant and equipment	(4,501)	(3,024)	(3,550)
Purchases of available-for-sale investments	(9,224)	(4,683)	(685)
Sales of available-for-sale investments	153	225	114
Maturities and other changes in available-for-sale investments	6,713	2,214	1,444
Net cash (used for) investing activities	**(6,859)**	**(5,268)**	**(2,677)**
Cash flows provided by (used for) financing activities:			
(Decrease) increase in short-term debt, net	(177)	43	(179)
Additions to long-term debt	172	317	—
Retirement of long-term debt	(300)	—	(4)
Proceeds from sales of shares through employee stock plans and other	357	261	192
Proceeds from sales of put warrants	288	56	85
Repurchase and retirement of Common Stock	(3,372)	(1,302)	(1,034)
Payment of dividends to stockholders	(180)	(148)	(116)
Net cash (used for) financing activities	**(3,212)**	**(773)**	**(1,056)**
Net (decrease) increase in cash and cash equivalents	**(63)**	**2,702**	**283**
Cash and cash equivalents, end of year	**$ 4,102**	**$ 4,165**	**$ 1,463**
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 37	$ 51	$ 182
Income taxes	$ 3,305	$ 2,217	$ 1,209

Cash paid for interest in 1995 includes approximately $108 million of accumulated interest on Zero Coupon Notes that matured in 1995.

Certain 1996 and 1995 amounts have been reclassified to conform to the 1997 presentation.

See accompanying notes.

Consolidated statements of stockholders' equity

Three years ended December 27, 1997
(In millions)

	Common Stock and capital in excess of par value			
	Number of shares	*Amount*	*Retained earnings*	*Total*
Balance at December 31, 1994	**1,654**	**$ 2,306**	**$ 6,961**	**$ 9,267**
Proceeds from sales of shares through employee stock plans, tax benefit of $116 and other	27	310	—	310
Proceeds from sales of put warrants	—	85	—	85
Reclassification of put warrant obligation, net	—	61	(42)	19
Repurchase and retirement of Common Stock	(38)	(179)	(855)	(1,034)
Cash dividends declared ($.075 per share)	—	—	(124)	(124)
Unrealized gain on available-for-sale investments, net	—	—	51	51
Net income	—	—	3,566	3,566
Balance at December 30, 1995	**1,643**	**2,583**	**9,557**	**12,140**
Proceeds from sales of shares through employee stock plans, tax benefit of $196 and other	33	457	—	457
Proceeds from sales of put warrants	—	56	—	56
Reclassification of put warrant obligation, net	—	70	272	342
Repurchase and retirement of Common Stock	(34)	(269)	(925)	(1,194)
Cash dividends declared ($.095 per share)	—	—	(156)	(156)
Unrealized gain on available-for-sale investments, net	—	—	70	70
Net income	—	—	5,157	5,157
Balance at December 28, 1996	**1,642**	**2,897**	**13,975**	**16,872**
Proceeds from sales of shares through employee stock plans, tax benefit of $224 and other	30	581	(1)	580
Proceeds from sales of put warrants	—	288	—	288
Reclassification of put warrant obligation, net	—	(144)	(1,622)	(1,766)
Repurchase and retirement of Common Stock	(44)	(311)	(3,061)	(3,372)
Cash dividends declared ($.115 per share)	—	—	(188)	(188)
Unrealized loss on available-for-sale investments, net	—	—	(64)	(64)
Net income	—	—	6,945	6,945
Balance at December 27, 1997	**1,628**	**$ 3,311**	**$ 15,984**	**$ 19,295**

See accompanying notes.

Notes to consolidated financial statements

Accounting policies

Fiscal year. Intel Corporation ("Intel" or "the Company") has a fiscal year that ends the last Saturday in December. Fiscal years 1997, 1996 and 1995, each 52-week years, ended on December 27, 28 and 30, respectively. Periodically, there will be a 53-week year. The next 53-week year will end on December 30, 2000.

Basis of presentation. The consolidated financial statements include the accounts of Intel and its wholly owned subsidiaries. Significant intercompany accounts and transactions have been eliminated. Accounts denominated in foreign currencies have been remeasured into the functional currency in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation," using the U.S. dollar as the functional currency.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Investments. Highly liquid investments with insignificant interest rate risk and with original maturities of three months or less are classified as cash and cash equivalents. Investments with maturities greater than three months and less than one year are classified as short-term investments. Investments with maturities greater than one year are classified as long-term investments.

The Company accounts for investments in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The Company's policy is to protect the value of its investment portfolio and to minimize principal risk by earning returns based on current interest rates. For equity investments entered into for the promotion of business and strategic objectives, an insignificant portion of the investment portfolio, the Company typically does not attempt to reduce or eliminate the inherent market risks. A substantial majority of the Company's marketable investments are classified as available-for-sale as of the balance sheet date and are reported at fair value, with unrealized gains and losses, net of tax, recorded in stockholders' equity. The cost of securities sold is based on the specific identification method. Realized gains or losses and declines in value, if any, judged to be other than temporary, on available-for-sale securities are reported in other income or expense. Investments in non-marketable instruments are recorded at the lower of cost or market and included in other assets.

Trading assets. During 1996, the Company began purchasing securities classified as trading assets. Net gains on the trading asset portfolio were $37 million and $12 million in 1997 and 1996, respectively. The Company maintains its trading asset portfolio to generate returns that offset changes in certain liabilities related to deferred compensation arrangements. The trading assets consist of marketable equity securities and are stated at fair value. Both realized and unrealized gains and losses are included in other income or expense and generally offset the change in the deferred compensation liability, which is also included in other income or expense.

Fair values of financial instruments. Fair values of cash and cash equivalents approximate cost due to the short period of time to maturity. Fair values of long-term investments, long-term debt, short-term investments, short-term debt, long-term debt redeemable within one year, trading assets, non-marketable instruments, swaps, currency forward contracts, currency options and options hedging marketable instruments are based on quoted market prices or pricing models using current market rates. No consideration is given to liquidity issues in valuing debt.

Derivative financial instruments. The Company utilizes derivative financial instruments to reduce financial market risks. These instruments are used to hedge foreign currency, equity and interest rate market exposures of underlying assets, liabilities and other obligations. The Company does not use derivative financial instruments for speculative or trading purposes. The Company's accounting policies for these instruments are based on the Company's designation of such instruments as hedging transactions. The criteria the Company uses for designating an instrument as a hedge include the instrument's effectiveness in risk reduction and one-to-one matching of derivative instruments to underlying transactions. Gains and losses on currency forward contracts and options that are designated and effective as hedges of anticipated transactions, for which a firm commitment has been attained, are deferred and recognized in income in the same period that the underlying transactions are settled. Gains and losses on currency forward contracts, options and swaps that are designated and effective as hedges of existing transactions are recognized in income in the same period as losses and gains on the underlying transactions are recognized and generally offset. Gains and losses on any instruments not meeting the above criteria would be recognized in income in the current period. If an underlying hedged transaction is terminated earlier than initially anticipated, the offsetting gain or loss on the related derivative instrument would be recognized in income in the same period. Subsequent gains or losses on the related derivative instrument would be recognized in income in each period until the instrument matures, is terminated or is sold. Income or expense on swaps is accrued as an adjustment to the yield of the related investments or debt they hedge.

Inventories. Inventories are stated at the lower of cost or market. Cost is computed on a currently adjusted standard basis (which approximates actual cost on a current average or first-in, first-out basis). Inventories at fiscal year-ends were as follows:

(In millions)	*1997*	*1996*
Raw materials	$ 255	$ 280
Work in process	928	672
Finished goods	514	341
Total	**$ 1,697**	**$ 1,293**

Notes to consolidated financial statements

Property, plant and equipment. Property, plant and equipment are stated at cost. Depreciation is computed for financial reporting purposes principally by use of the straight-line method over the following estimated useful lives: machinery and equipment, 2–4 years; land and buildings, 4–40 years.

The Company evaluates property, plant and equipment in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of."

Deferred income on shipments to distributors. Certain of the Company's sales are made to distributors under agreements allowing price protection and/or right of return on merchandise unsold by the distributors. Because of frequent sales price reductions and rapid technological obsolescence in the industry, Intel defers recognition of such sales until the merchandise is sold by the distributors.

Advertising. Cooperative advertising obligations are accrued and the costs expensed at the same time the related revenue is recognized. All other advertising costs are expensed as incurred. The Company does not incur any direct-response advertising costs. Advertising expense was $1,203 million, $974 million and $654 million in 1997, 1996 and 1995, respectively.

Interest. Interest as well as gains and losses related to contractual agreements to hedge certain investment positions and debt (see "Derivative financial instruments") are recorded as net interest income or expense on a monthly basis. Interest expense capitalized as a component of construction costs was $9 million, $33 million and $46 million for 1997, 1996 and 1995, respectively.

Earnings per share. The consolidated financial statements are presented in accordance with SFAS No. 128, "Earnings per Share." Basic earnings per common share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per common share incorporate the incremental shares issuable upon the assumed exercise of stock options and warrants. Diluted earnings per common share do not differ from the Company's previously reported earnings per common and common equivalent share.

Stock distribution. On July 13, 1997, the Company effected a two-for-one stock split in the form of a special stock distribution to stockholders of record as of June 10, 1997. All share, per share, Common Stock, stock option and warrant amounts herein have been restated to reflect the effect of this split.

Recent accounting pronouncements. The Company intends to adopt SFAS No. 130, "Reporting Comprehensive Income," and SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," in fiscal 1998. Both will require additional disclosure but will not have a material effect on the Company's financial position or results of operations. SFAS No. 130 will first be reflected in the Company's first quarter of 1998 interim financial statements. Components of comprehensive income for the Company include items such as net income and changes in the value of available-for-sale securities. SFAS No. 131 requires segments to be determined based on how management measures performance and makes decisions about allocating resources. SFAS No. 131 will first be reflected in the Company's 1998 Annual Report.

Common Stock

1998 Step-Up Warrants. In 1993, the Company issued 80 million 1998 Step-Up Warrants to purchase 80 million shares of Common Stock. This transaction resulted in an increase of $287 million in Common Stock and capital in excess of par value, representing net proceeds from the offering. The Warrants became exercisable in May 1993 at an effective price of $17.875 per share of Common Stock, subject to annual increases to a maximum price of $20.875 per share effective in March 1997. As of December 27, 1997, approximately 78 million Warrants were exercisable at a price of $20.875 per Warrant. These Warrants expire on March 14, 1998.

Stock repurchase program. The Company has an ongoing authorization, as amended, from the Board of Directors to repurchase up to 280 million shares of Intel's Common Stock and Step-Up Warrants in open market or negotiated transactions. During 1997, the Company repurchased 43.6 million shares of Common Stock at a cost of $3.4 billion. As of December 27, 1997, the Company had repurchased and retired approximately 213.4 million shares at a cost of $6.9 billion since the program began in 1990. As of December 27, 1997, after reserving 26.3 million shares to cover outstanding put warrants, 40.3 million shares remained available under the repurchase authorization.

Put warrants

In a series of private placements from 1991 through 1997, the Company sold put warrants that entitle the holder of each warrant to sell to the Company, by physical delivery, one share of Common Stock at a specified price. On certain of these warrants, the Company simultaneously entered into additional contractual arrangements which cause the warrants to terminate if the Company's stock price reaches specified levels. Activity during the past three years is summarized as follows:

		Put warrants outstanding	
(In millions)	*Cumulative net premium received*	*Number of warrants*	*Potential obligation*
December 31, 1994	**$ 194**	**50.0**	**$ 744**
Sales	85	35.0	925
Repurchases	—	(11.0)	(201)
Expirations	—	(50.0)	(743)
December 30, 1995	**279**	**24.0**	**725**
Sales	56	18.0	603
Exercises	—	(3.6)	(108)
Expirations	—	(29.4)	(945)
December 28, 1996	**335**	**9.0**	**275**
Sales	288	46.3	3,525
Expirations	—	(29.0)	(1,759)
December 27, 1997	**$ 623**	**26.3**	**$ 2,041**

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The amount related to Intel's potential repurchase obligation has been reclassified from stockholders' equity to put warrants. The 26.3 million put warrants outstanding at December 27, 1997 expire on various dates between February and August 1998 and have exercise prices ranging from $68 to $95 per share, with an average exercise price of $78 per share. There is no significant effect on diluted earnings per share for the periods presented.

Borrowings

Short-term debt. Short-term debt and weighted average interest rates at fiscal year-ends were as follows:

	1997		1996	
(In millions)	*Balance*	*Weighted average interest rate*	*Balance*	*Weighted average interest rate*
Borrowed under lines of credit	$ 32	N/A	$ 30	N/A
Reverse repurchase agreements payable in non-U.S. currencies	—	—	263	6.4%
Notes payable	—	—	3	0.7%
Drafts payable	180	N/A	93	N/A
Total	**$ 212**		**$ 389**	

The Company also borrows under commercial paper programs. Maximum borrowings under commercial paper programs reached $175 million during 1997 and $306 million during 1996. This debt is rated A-1+ by Standard and Poor's and P-1 by Moody's. Proceeds are used to fund short-term working capital needs.

Long-term debt. Long-term debt at fiscal year-ends was as follows:

(In millions)	*1997*	*1996*
Payable in U.S. dollars:		
AFICA Bonds due 2013 at 4%	$ 110	$ 110
Reverse repurchase arrangement due 2001	—	300
Other U.S. dollar debt	6	4
Payable in other currencies:		
Irish punt due 1999–2027 at 5%–12%	396	268
Greek drachma due 2001	46	46
Subtotal	558	728
Less long-term debt redeemable within one year	(110)	—
Total	**$ 448**	**$ 728**

The Company has guaranteed repayment of principal and interest on the AFICA Bonds issued by the Puerto Rico Industrial, Medical and Environmental Pollution Control Facilities Financing Authority ("AFICA"). The bonds are adjustable and redeemable at the option of either the Company or the bondholder every five years through 2013. They are next adjustable and redeemable in 1998 and accordingly have been reclassified as a current liability at December 27, 1997. The Irish punt borrowings were made in connection with the financing of a factory in Ireland, and Intel has invested the proceeds in Irish punt denominated instruments of similar maturity to hedge foreign currency and interest rate exposures. The Greek drachma borrowings were made under a tax incentive program in Ireland, and the proceeds and cash flows have been swapped to U.S. dollars. The $300 million reverse repurchase arrangement originally payable in 2001 was repaid in 1997. It had a borrowing rate of 5.9% at December 28, 1996.

Under shelf registration statements filed with the Securities and Exchange Commission, Intel originally had the authority to issue up to $3.3 billion in the aggregate of Common Stock, Preferred Stock, depositary shares, debt securities and warrants to purchase the Company's or other issuers' Common Stock, Preferred Stock and debt securities, and, subject to certain limits, stock index warrants and foreign currency exchange units. In 1993, Intel completed an offering of Step-Up Warrants (see "1998 Step-Up Warrants") under these registration statements. The Company may issue up to approximately $1.4 billion in additional securities under effective registration statements.

As of December 27, 1997, aggregate debt maturities were as follows: 1998–$110 million; 1999–$7 million; 2000–$5 million; 2001–$56 million; 2002–$15 million; and thereafter–$365 million.

Investments

The returns on a majority of the Company's marketable investments in long-term fixed rate debt and equity securities are swapped to U.S. dollar LIBOR-based returns. The currency risks of investments denominated in foreign currencies are hedged with foreign currency borrowings, currency forward contracts or currency interest rate swaps (see "Derivative financial instruments" under "Accounting policies").

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Investments with maturities of greater than six months consist primarily of A and A2 or better rated financial instruments and counterparties. Investments with maturities of up to six months consist primarily of A-1 and P-1 or better rated financial instruments and counterparties. Foreign government regulations imposed upon investment alternatives of foreign subsidiaries, or the absence of A and A2 rated counterparties in certain countries, result in some minor exceptions. Intel's practice is to obtain and secure available collateral from counterparties against obligations whenever Intel deems appropriate. At December 27, 1997, investments were placed with approximately 250 different counterparties.

Investments at December 27, 1997 were as follows:

(In millions)	*Cost*	*Gross unrealized gains*	*Gross unrealized losses*	*Estimated fair value*
Commercial paper	$ 3,572	$ 1	$ (9)	$ 3,564
Bank deposits	2,369	—	(2)	2,367
Corporate bonds	1,788	12	(73)	1,727
Floating rate notes	843	1	(2)	842
Loan participations	743	—	—	743
Repurchase agreements	515	—	—	515
Securities of foreign governments	75	—	(6)	69
Fixed rate notes	32	—	—	32
Other debt securities	294	—	(1)	293
Total debt securities	10,231	14	(93)	10,152
Hedged equity	504	9	(17)	496
Preferred stock and other equity	620	131	(41)	710
Total equity securities	1,124	140	(58)	1,206
Swaps hedging investments in debt securities	—	76	(12)	64
Swaps hedging investments in equity securities	—	17	(9)	8
Currency forward contracts hedging investments in debt securities	—	16	(1)	15
Total available-for-sale securities	**11,355**	**263**	**(173)**	**11,445**
Less amounts classified as cash equivalents	(3,976)	—	—	(3,976)
Total investments	**$ 7,379**	**$ 263**	**$ (173)**	**$ 7,469**

Investments at December 28, 1996 were as follows:

(In millions)	*Cost*	*Gross unrealized gains*	*Gross unrealized losses*	*Estimated fair value*
Commercial paper	$ 2,386	$ —	$ (1)	$ 2,385
Bank deposits	1,846	—	(2)	1,844
Repurchase agreements	931	—	(1)	930
Loan participations	691	—	—	691
Corporate bonds	657	10	(6)	661
Floating rate notes	366	—	—	366
Securities of foreign governments	265	14	(2)	277
Fixed rate notes	262	—	—	262
Other debt securities	284	—	(2)	282
Total debt securities	7,688	24	(14)	7,698
Hedged equity	891	71	(15)	947
Preferred stock and other equity	270	174	(3)	441
Total equity securities	1,161	245	(18)	1,388
Swaps hedging investments in debt securities	—	5	(17)	(12)
Swaps hedging investments in equity securities	—	15	(42)	(27)
Options hedging investments in equity securities	(9)	—	(16)	(25)
Currency forward contracts hedging investments in debt securities	—	5	—	5
Total available-for-sale securities	**8,840**	**294**	**(107)**	**9,027**
Less amounts classified as cash equivalents	(3,932)	—	—	(3,932)
Total investments	**$ 4,908**	**$ 294**	**$ (107)**	**$ 5,095**

Available-for-sale securities with a fair value at the date of sale of $153 million, $225 million and $114 million were sold in 1997, 1996 and 1995, respectively. The gross realized gains on these sales totaled $106 million, $7 million and $60 million, respectively.

The amortized cost and estimated fair value of investments in debt securities at December 27, 1997, by contractual maturity, were as follows:

(In millions)	*Cost*	*Estimated fair value*
Due in 1 year or less	$ 8,925	$ 8,863
Due in 1–2 years	638	620
Due in 2–5 years	293	295
Due after 5 years	375	374
Total investments in debt securities	**$10,231**	**$10,152**

Notes to consolidated financial statements

Derivative financial instruments

Outstanding notional amounts for derivative financial instruments at fiscal year-ends were as follows:

(In millions)	1997	1996
Swaps hedging investments in debt securities	$ 2,017	$ 900
Swaps hedging investments in equity securities	$ 604	$ 918
Swaps hedging debt	$ 155	$ 456
Currency forward contracts	$ 1,724	$ 1,499
Currency options	$ 55	$ 94
Options hedging investments in marketable equity securities	$ —	$ 82

While the contract or notional amounts provide one measure of the volume of these transactions, they do not represent the amount of the Company's exposure to credit risk. The amounts potentially subject to credit risk (arising from the possible inability of counterparties to meet the terms of their contracts) are generally limited to the amounts, if any, by which the counterparties' obligations exceed the obligations of the Company. The Company controls credit risk through credit approvals, limits and monitoring procedures. Credit rating criteria for off-balance-sheet transactions are similar to those for investments.

Swap agreements. The Company utilizes swap agreements to exchange the foreign currency, equity and interest rate returns of its investment and debt portfolios for floating U.S. dollar interest rate based returns. The floating rates on swaps are based primarily on U.S. dollar LIBOR and are reset on a monthly, quarterly or semiannual basis.

Pay rates on swaps hedging investments in debt securities match the yields on the underlying investments they hedge. Payments on swaps hedging investments in equity securities match the equity returns on the underlying investments they hedge. Receive rates on swaps hedging debt match the expense on the underlying debt they hedge. Maturity dates of swaps match those of the underlying investment or the debt they hedge. There is approximately a one-to-one matching of swaps to investments and debt. Swap agreements remain in effect until expiration.

Weighted average pay and receive rates, average maturities and range of maturities on swaps at December 27, 1997 were as follows:

	Weighted average pay rate	Weighted average receive rate	Weighted average maturity	Range of maturities
Swaps hedging investments in U.S. dollar debt securities	6.1%	5.8%	.9 years	0–3 years
Swaps hedging investments in foreign currency debt securities	6.3%	5.9%	1.0 years	0–3 years
Swaps hedging investments in equity securities	N/A	5.7%	.6 years	0–2 years
Swaps hedging debt	5.9%	5.2%	1.6 years	0–4 years

Note: Pay and receive rates are based on the reset rates that were in effect at December 27, 1997.

Other foreign currency instruments. Intel transacts business in various foreign currencies, primarily Japanese yen and certain other Asian and European currencies. The Company has established revenue and balance sheet hedging programs to protect against reductions in value and volatility of future cash flows caused by changes in foreign exchange rates. The Company utilizes currency forward contracts and currency options in these hedging programs. The maturities on these instruments are less than 12 months. Deferred gains or losses attributable to foreign currency instruments are not material.

Fair values of financial instruments

The estimated fair values of financial instruments outstanding at fiscal year-ends were as follows:

	1997		1996	
(In millions)	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Cash and cash equivalents	$ 4,102	$ 4,102	$ 4,165	$ 4,165
Short-term investments	$ 5,561	$ 5,561	$ 3,736	$ 3,736
Trading assets	$ 195	$ 195	$ 87	$ 87
Long-term investments	$ 1,821	$ 1,821	$ 1,418	$ 1,418
Non-marketable instruments	$ 387	$ 497	$ 119	$ 194
Swaps hedging investments in debt securities	$ 64	$ 64	$ (12)	$ (12)
Swaps hedging investments in equity securities	$ 8	$ 8	$ (27)	$ (27)
Options hedging investments in marketable equity securities	$ —	$ —	$ (25)	$ (25)
Short-term debt	$ (212)	$ (212)	$ (389)	$ (389)
Long-term debt redeemable within one year	$ (110)	$ (109)	$ —	$ —
Long-term debt	$ (448)	$ (448)	$ (728)	$ (731)
Swaps hedging debt	$ —	$ (1)	$ —	$ 13
Currency forward contracts	$ 26	$ 28	$ 5	$ 18
Currency options	$ 1	$ 1	$ —	$ —

Concentrations of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of investments and trade receivables. Intel places its investments with high-credit-quality counterparties and, by policy, limits the amount of credit exposure to any one counterparty based on Intel's analysis of that counterparty's relative credit standing. A majority of the Company's trade receivables are derived from sales to manufacturers of computer systems, with the remainder spread across various other industries. The Company's five largest customers accounted for approximately 39% of net revenues for 1997. At December 27, 1997, these customers accounted for approximately 34% of net accounts receivable.

The Company endeavors to keep pace with the evolving computer industry and has adopted credit policies and standards intended to accommodate industry growth and inherent risk. Management believes that credit risks are moderated by the diversity of its end customers and geographic sales areas. Intel performs ongoing credit evaluations of its customers' financial condition and requires collateral as deemed necessary.

Notes to consolidated financial statements

Interest income and other

(In millions)	1997	1996	1995
Interest income	$ 562	$ 364	$ 272
Foreign currency gains	63	26	29
Other income	174	16	114
Total	**$ 799**	**$ 406**	**$ 415**

Other income for 1997 includes approximately $106 million from sales of a portion of the Company's investments in marketable equity securities. Other income for 1995 included approximately $58 million from the settlement of ongoing litigation and $60 million from sales of a portion of the Company's investments in marketable equity securities.

Provision for taxes

The provision for taxes consisted of the following:

(In millions)	1997	1996	1995
Income before taxes:			
U.S.	$ 8,033	$ 5,515	$ 3,427
Foreign	2,626	2,419	2,211
Total income before taxes	**$10,659**	**$ 7,934**	**$ 5,638**
Provision for taxes:			
Federal:			
Current	$ 2,930	$ 2,046	$ 1,169
Deferred	30	8	307
	2,960	2,054	1,476
State:			
Current	384	286	203
Foreign:			
Current	394	266	354
Deferred	(24)	171	39
	370	437	393
Total provision for taxes	**$ 3,714**	**$ 2,777**	**$ 2,072**
Effective tax rate	**34.8%**	**35.0%**	**36.8%**

The tax benefit associated with dispositions from employee stock plans reduced taxes currently payable for 1997 by $224 million ($196 million and $116 million for 1996 and 1995, respectively).

The provision for taxes reconciles to the amount computed by applying the statutory federal rate of 35% to income before taxes as follows:

(In millions)	1997	1996	1995
Computed expected tax	$ 3,731	$ 2,777	$ 1,973
State taxes, net of federal benefits	249	186	132
Other	(266)	(186)	(33)
Provision for taxes	**$ 3,714**	**$ 2,777**	**$ 2,072**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of the Company's deferred tax assets and liabilities at fiscal year-ends were as follows:

(In millions)	1997	1996
Deferred tax assets		
Accrued compensation and benefits	$ 76	$ 71
Deferred income	200	147
Inventory valuation and related reserves	163	187
Interest and taxes	49	54
Other, net	188	111
	676	570
Deferred tax liabilities		
Depreciation	(882)	(573)
Unremitted earnings of certain subsidiaries	(162)	(359)
Other, net	(32)	(65)
	(1,076)	(997)
Net deferred tax (liability)	**$ (400)**	**$ (427)**

U.S. income taxes were not provided for on a cumulative total of approximately $1,505 million of undistributed earnings for certain non-U.S. subsidiaries. The Company intends to reinvest these earnings indefinitely in operations outside the United States.

During 1997, the Company officially settled all tax and related interest for years 1978 through 1990 with the Internal Revenue Service ("IRS"). There was no material effect on the Company's 1997 financial statements.

The Company's U.S. income tax returns for the years 1991 through 1993 are presently under examination by the IRS. Final proposed adjustments have not yet been received for these years. In addition, examination by the IRS of the Company's income tax returns for the years 1994 through 1996 began in 1997. Management believes that adequate amounts of tax and related interest and penalties, if any, have been provided for any adjustments that may result for the years under examination.

Employee benefit plans

Stock option plans. Intel has a 1984 Stock Option Plan under which officers, key employees and non-employee directors may be granted options to purchase shares of the Company's authorized but unissued Common Stock. In 1997, the Board of Directors approved the 1997 Stock Option Plan, which made an additional 130 million shares available for employees other than officers and directors. The Company also has an Executive Long-Term Stock Option Plan under which certain employees, including officers, may be granted options to purchase shares of the Company's authorized but unissued Common Stock. Under all of the plans, the option exercise price is equal to fair market value at the date of grant.

Options currently expire no later than 10 years from the grant date and generally vest after 5 years. Proceeds received by the Company from exercises are credited to Common Stock and

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capital in excess of par value. Additional information with respect to stock option plan activity was as follows:

(In millions)	*Shares available for options*	*Outstanding options: Number of shares*	*Outstanding options: Weighted average exercise price*
December 31, 1994	**108.9**	**170.3**	**$ 7.64**
Grants	(27.9)	27.9	$ 24.11
Exercises	—	(21.3)	$ 4.07
Cancellations	5.9	(5.9)	$ 12.83
December 30, 1995	**86.9**	**171.0**	**$ 10.60**
Grants	(26.7)	26.7	$ 34.56
Exercises	—	(23.7)	$ 4.93
Cancellations	5.1	(5.1)	$ 17.05
December 28, 1996	**65.3**	**168.9**	**$ 14.98**
Additional shares reserved	130.0	—	—
Grants	(31.5)	31.5	$ 72.46
Exercises	—	(23.6)	$ 6.11
Cancellations	4.4	(4.4)	$ 32.76
December 27, 1997	**168.2**	**172.4**	**$ 26.24**
Options exercisable at:			
December 30, 1995		58.2	$ 4.55
December 28, 1996		57.3	$ 5.72
December 27, 1997		57.6	$ 7.33

The range of exercise prices for options outstanding at December 27, 1997 was $2.52 to $97.94. The range of exercise prices for options is wide due primarily to the increasing price of the Company's stock over the period when the grants were made.

The following tables summarize information about options outstanding at December 27, 1997:

Range of exercise prices	*Outstanding options: Number of shares (in millions)*	*Weighted average contractual life (in years)*	*Weighted average exercise price*
$2.52–$9.78	49.2	2.9	$ 5.34
$11.09–$20.56	45.1	5.8	$ 14.04
$22.20–$48.47	46.5	7.9	$ 28.95
$52.09–$97.94	31.6	9.4	$ 72.12
Total	**172.4**	**6.2**	**$ 26.24**

Range of exercise prices	*Exercisable options: Number of shares (in millions)*	*Weighted average exercise price*
$2.52–$9.78	49.1	$ 5.34
$11.09–$20.56	6.2	$ 13.90
$22.20–$48.47	2.1	$ 29.86
$52.09–$97.94	.2	$ 60.09
Total	**57.6**	**$ 7.33**

These options will expire if not exercised at specific dates ranging from January 1998 to December 2007. Prices for options exercised during the three-year period ended December 27, 1997 ranged from $1.52 to $61.31.

Stock Participation Plan. Under this plan, eligible employees may purchase shares of Intel's Common Stock at 85% of fair market value at specific, predetermined dates. Of the 236 million shares authorized to be issued under the plan, 43.0 million shares were available for issuance at December 27, 1997. Employees purchased 4.5 million shares in 1997 (7.0 million in 1996 and in 1995) for $191 million ($140 million and $110 million in 1996 and 1995, respectively).

Pro forma information. The Company has elected to follow APB Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS No. 123, "Accounting for Stock-Based Compensation," requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB No. 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized in the Company's financial statements.

Pro forma information regarding net income and earnings per share is required by SFAS No. 123. This information is required to be determined as if the Company had accounted for its employee stock options (including shares issued under the Stock Participation Plan, collectively called "options") granted subsequent to December 31, 1994 under the fair value method of that statement. The fair value of options granted in 1997, 1996 and 1995 reported below has been estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

Employee stock options	*1997*	*1996*	*1995*
Expected life (in years)	6.5	6.5	6.5
Risk-free interest rate	6.6%	6.5%	6.8%
Volatility	.36	.36	.36
Dividend yield	.1%	.2%	.3%

Stock Participation Plan shares	*1997*	*1996*	*1995*
Expected life (in years)	.5	.5	.5
Risk-free interest rate	5.3%	5.3%	6.0%
Volatility	.40	.36	.36
Dividend yield	.1%	.2%	.3%

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the

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Company's options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of its options. The weighted average estimated fair value of employee stock options granted during 1997, 1996 and 1995 was $35.33, $16.35 and $11.63 per share, respectively. The weighted average estimated fair value of shares granted under the Stock Participation Plan during 1997, 1996 and 1995 was $22.08, $8.11 and $6.13, respectively.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting periods. The Company's pro forma information follows (in millions except for earnings per share information):

	1997	*1996*	*1995*
Pro forma net income	$ 6,735	$ 5,046	$ 3,506
Pro forma basic earnings per share	$ 4.12	$ 3.07	$ 2.12
Pro forma diluted earnings per share	$ 3.76	$ 2.84	$ 1.98

The effects on pro forma disclosures of applying SFAS No. 123 are not likely to be representative of the effects on pro forma disclosures of future years. Because SFAS No. 123 is applicable only to options granted subsequent to December 31, 1994, the pro forma effect will not be fully reflected until 1999.

Retirement plans. The Company provides tax-qualified profit-sharing retirement plans (the "Qualified Plans") for the benefit of eligible employees in the U.S. and Puerto Rico and certain foreign countries. The plans are designed to provide employees with an accumulation of funds for retirement on a tax-deferred basis and provide for annual discretionary contributions to trust funds.

The Company also provides a non-qualified profit-sharing retirement plan (the "Non-Qualified Plan") for the benefit of eligible employees in the U.S. This plan is designed to permit certain discretionary employer contributions in excess of the tax limits applicable to the Qualified Plans and to permit employee deferrals in excess of certain tax limits. This plan is unfunded.

The Company accrued $273 million for the Qualified Plans and the Non-Qualified Plan in 1997 ($209 million in 1996 and $188 million in 1995). Of the $273 million accrued in 1997, the Company expects to fund approximately $245 million for the 1997 contribution to the Qualified Plans and to allocate approximately $12 million for the Non-Qualified Plan. The remainder, plus approximately $193 million carried forward from prior years, is expected to be contributed to these plans when allowable under IRS regulations and plan rules.

Contributions made by the Company vest based on the employee's years of service. Vesting begins after three years of service in 20% annual increments until the employee is 100% vested after seven years.

The Company provides tax-qualified defined-benefit pension plans for the benefit of eligible employees in the U.S. and Puerto Rico. Each plan provides for minimum pension benefits that are determined by a participant's years of service, final average compensation (taking into account the participant's social security wage base) and the value of the Company's contributions, plus earnings, in the Qualified Plan. If the participant's balance in the Qualified Plan exceeds the pension guarantee, the participant will receive benefits from the Qualified Plan only. Intel's funding policy is consistent with the funding requirements of federal laws and regulations.

Pension expense for 1997, 1996 and 1995 for the U.S. and Puerto Rico plans was less than $1 million per year, and no component of expense exceeded $4 million.

The funded status of these plans as of December 27, 1997 and December 28, 1996 was as follows:

(In millions)	*1997*	*1996*
Vested benefit obligation	$ (5)	$ (3)
Accumulated benefit obligation	$ (5)	$ (4)
Projected benefit obligation	$ (6)	$ (5)
Fair market value of plan assets	14	11
Projected benefit obligation less than plan assets	8	6
Unrecognized net (gain)	(15)	(15)
Unrecognized prior service cost	2	3
Accrued pension costs	$ (5)	$ (6)

At fiscal year-ends, significant assumptions used were as follows:

	1997	*1996*	*1995*
Discount rate	7.0%	7.0%	7.0%
Rate of compensation increase	5.0%	5.0%	5.0%
Expected long-term return on assets	8.5%	8.5%	8.5%

Plan assets of the U.S. and Puerto Rico plans consist primarily of listed stocks and bonds, repurchase agreements, money market securities, U.S. government securities and stock index derivatives.

The Company provides defined-benefit pension plans in certain foreign countries where required by statute. The Company's funding policy for foreign defined-benefit plans is consistent with the local requirements in each country.

Pension expense for 1997, 1996 and 1995 for the foreign plans was $14 million, $17 million and $9 million, respectively. No component of expense exceeded $15 million.

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The funded status of the foreign defined-benefit plans as of December 27, 1997 and December 28, 1996 is summarized below:

1997 *(In millions)*	*Assets exceed accu-mulated benefits*	*Accu-mulated benefits exceed assets*
Vested benefit obligation	**$ (43)**	**$ (11)**
Accumulated benefit obligation	**$ (49)**	**$ (17)**
Projected benefit obligation	$ (71)	$ (26)
Fair market value of plan assets	78	4
Projected benefit obligation less than (in excess of) plan assets	7	(22)
Unrecognized net loss	3	2
Unrecognized net transition obligation	2	1
Prepaid (accrued) pension costs	**$ 12**	**$ (19)**

1996 *(In millions)*	*Assets exceed accu-mulated benefits*	*Accu-mulated benefits exceed assets*
Vested benefit obligation	**$ (43)**	**$ (9)**
Accumulated benefit obligation	**$ (46)**	**$ (15)**
Projected benefit obligation	$ (62)	$ (23)
Fair market value of plan assets	68	3
Projected benefit obligation less than (in excess of) plan assets	6	(20)
Unrecognized net loss	3	3
Unrecognized net transition obligation	2	1
Prepaid (accrued) pension costs	**$ 11**	**$ (16)**

At fiscal year-ends, significant assumptions used were as follows:

	1997	*1996*	*1995*
Discount rate	5.5%–14%	5.5%–14%	5.5%–14%
Rate of compensation increase	4.5%–11%	4.5%–11%	4.5%–11%
Expected long-term return on assets	5.5%–14%	5.5%–14%	5.5%–14%

Plan assets of the foreign plans consist primarily of listed stocks, bonds and cash surrender value life insurance policies.

Other postemployment benefits. The Company accounts for other postemployment benefits in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and SFAS No. 112, "Employers' Accounting for Postemployment Benefits." These benefits had no material impact on the Company's financial statements for the periods presented.

Commitments

The Company leases a portion of its capital equipment and certain of its facilities under operating leases that expire at various dates through 2010. Rental expense was $69 million in 1997, $57 million in 1996 and $38 million in 1995. Minimum rental commitments under all non-cancelable leases with an initial term in excess of one year are payable as follows: 1998–$37 million; 1999–$33 million; 2000–$18 million; 2001–$13 million; 2002–$12 million; 2003 and beyond–$17 million. Commitments for construction or purchase of property, plant and equipment approximated $3.3 billion at December 27, 1997. In connection with certain manufacturing arrangements, Intel had minimum purchase commitments of approximately $191 million at December 27, 1997 for flash memories and other memory components.

In October 1997, the Company and Digital Equipment Corporation ("Digital") announced that they have agreed to establish a broad-based business relationship. The agreement includes sale of Digital's semiconductor manufacturing operations to Intel for approximately $700 million, a 10-year patent cross-license, supply of both Intel and Alpha microprocessors by Intel to Digital, development by Digital of future systems based on Intel's 64-bit microprocessors and termination of litigation between the companies as described below (see "Contingencies"). This agreement is subject to U.S. government review. The transactions provided for in the agreement are not expected to have a material adverse effect on the Company's financial condition or ongoing results of operations in any reporting period.

In January 1998, the Company acquired the outstanding shares of Chips and Technologies, Inc. of San Jose, California, for approximately $430 million as a result of a tender offer commenced in August 1997. The transaction will be accounted for as a purchase.

Contingencies

In March 1995, EMI Group, N.A. ("EMI", formerly known as Thorn EMI North America Inc.) brought suit in Federal District Court in Delaware against Intel, alleging that certain Intel manufacturing processes infringe a U.S. patent. In May 1996, the Court granted Intel's motion for summary judgment on some of the processes in issue. In November 1996, the Court granted Intel's motion for summary judgment on the remaining processes in issue and entered judgment in favor of Intel and against EMI on the claims in EMI's complaint. A hearing on EMI's appeal of the grant of summary judgment was heard in August 1997. No decision has been issued.

Notes to consolidated financial statements

Digital brought suit in Federal District Court in Massachusetts in May 1997, alleging that Intel is infringing 10 patents in making and selling microprocessor products. Digital sought an injunction and monetary damages. If granted, the injunction would prohibit Intel from using Digital's patented technology in its microprocessor products. The Company believes that its products do not infringe the Digital patents. The Company filed a counterclaim against Digital for infringement of nine microprocessor-related patents, and, in District Court in Oregon, the Company claimed that Digital infringes six video and computer system patents. In October 1997, Intel and Digital announced that they have agreed to establish a broad-based business relationship as described above (see "Commitments"). Among other matters, the two companies agreed to request a stay of all lawsuits until government review of the agreement is completed, following which the lawsuits would be dismissed with prejudice.

In November 1997, Intergraph Corporation ("Intergraph") filed suit in Federal District Court in Alabama generally alleging that Intel attempted to coerce Intergraph into relinquishing certain patent rights relating to microprocessor and chipset interaction in multiprocessor workstations. The suit also alleges that Intel infringes three Intergraph patents and includes alleged violations of antitrust laws. The suit seeks injunctive relief along with unspecified damages. In November 1997, Intel filed suit against Intergraph in Federal District Court in California seeking a declaratory judgment that the Intergraph patents are invalid. Intel also filed an action in the same court alleging breach of contract and misappropriation of trade secrets based on Intergraph's refusal to return Intel confidential information as contractually required.

Although the ultimate outcome of the legal proceedings noted above cannot be determined at this time, management, including internal counsel, does not believe that the outcome of these proceedings, individually and in the aggregate, will have a material adverse effect on the Company's financial position or overall trends in results of operations.

Intel has been named to the California and U.S. Superfund lists for three of its sites and has completed, along with two other companies, a Remedial Investigation/Feasibility study with the U.S. Environmental Protection Agency ("EPA") to evaluate the groundwater in areas adjacent to one of its former sites. The EPA has issued a Record of Decision with respect to a groundwater cleanup plan at that site, including expected costs to complete. Under the California and U.S. Superfund statutes, liability for cleanup of this site and the adjacent area is joint and several. The Company, however, has reached agreement with those same two companies which significantly limits the Company's liabilities under the proposed cleanup plan. Also, the Company has completed extensive studies at its other sites and is engaged in cleanup at several of these sites. In the opinion of management, including internal counsel, the potential losses to the Company in excess of amounts already accrued arising out of these matters will not have a material adverse effect on the Company's financial position or overall trends in results of operations, even if joint and several liability were to be assessed.

The Company is party to various other legal proceedings. In the opinion of management, including internal counsel, these proceedings will not have a material adverse effect on the Company's financial position or overall trends in results of operations.

The estimate of the potential impact on the Company's financial position or overall results of operations for the above legal proceedings could change in the future.

Industry segment reporting

Intel operates predominantly in one industry segment. The Company designs, develops, manufactures and markets microcomputer components and related products at various levels of integration. The Company sells its products directly to original equipment manufacturers ("OEMs") and also to a network of industrial and retail distributors throughout the world. The Company's principal markets are in the United States, Europe, Asia-Pacific and Japan, with the U.S. and Europe being the largest based on revenues. The Company's major products include microprocessors and related board-level products, chipsets, embedded processors and microcontrollers, flash memory chips, and network and communications products. Microprocessors and related board-level products account for a substantial majority of the Company's net revenues. In 1997, one customer accounted for 12% of the Company's revenues. No customer exceeded 10% of revenues in 1996 and 1995. Summary balance sheet information for operations outside the United States at fiscal year-ends is as follows:

(In millions)	*1997*	*1996*
Assets	$ 5,332	$ 4,784
Total liabilities	$ 2,127	$ 1,694
Net property, plant and equipment	$ 2,644	$ 1,615

Notes to consolidated financial statements

Geographic information for the three years ended December 27, 1997 is presented in the following tables. Transfers between geographic areas are accounted for at amounts that are generally above cost and consistent with rules and regulations of governing tax authorities. Such transfers are eliminated in the consolidated financial statements. Operating income by geographic segment does not include an allocation of general corporate expenses. Identifiable assets are those that can be directly associated with a particular geographic area. Corporate assets include cash and cash equivalents, short-term investments, trading assets, deferred tax assets, long-term investments and certain other assets.

(In millions)	*Sales to unaffiliated customers*	*Transfers between geographic areas*	*Net revenues*	*Operating income*	*Identifiable assets*
1997					
United States	$ 11,053	$ 12,155	$ 23,208	$ 7,734	$ 15,542
Europe	6,774	1,101	7,875	1,056	2,463
Asia-Pacific	4,754	2,659	7,413	549	1,849
Japan	2,489	26	2,515	184	394
Other	—	1,127	1,127	692	626
Eliminations	—	(17,068)	(17,068)	513	(4,365)
Corporate	—	—	—	(841)	12,371
Consolidated	**$ 25,070**	**$ —**	**$ 25,070**	**$ 9,887**	**$ 28,880**
1996					
United States	$ 8,668	$ 9,846	$ 18,514	$ 5,255	$ 12,982
Europe	5,876	917	6,793	1,118	2,405
Asia-Pacific	3,844	2,004	5,848	509	1,361
Japan	2,459	20	2,479	340	659
Other	—	865	865	529	359
Eliminations	—	(13,652)	(13,652)	453	(3,439)
Corporate	—	—	—	(651)	9,408
Consolidated	**$ 20,847**	**$ —**	**$ 20,847**	**$ 7,553**	**$ 23,735**
1995					
United States	$ 7,922	$ 6,339	$ 14,261	$ 3,315	$ 12,603
Europe	4,560	1,190	5,750	1,383	2,517
Asia-Pacific	1,983	1,566	3,549	271	893
Japan	1,737	28	1,765	353	665
Other	—	684	684	410	329
Eliminations	—	(9,807)	(9,807)	124	(3,651)
Corporate	—	—	—	(604)	4,148
Consolidated	**$ 16,202**	**$ —**	**$ 16,202**	**$ 5,252**	**$ 17,504**

Supplemental information (unaudited)

Quarterly information for the two years ended December 27, 1997 is presented on page 25.

Report of Ernst & Young LLP, independent auditors

The Board of Directors and Stockholders, Intel Corporation

We have audited the accompanying consolidated balance sheets of Intel Corporation as of December 27, 1997 and December 28, 1996, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 27, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Intel Corporation at December 27, 1997 and December 28, 1996, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 27, 1997, in conformity with generally accepted accounting principles.

Ernst & Young LLP

San Jose, California
January 12, 1998

Financial summary

Ten years ended December 27, 1997

(In millions)	*Net investment in property, plant & equipment*	*Total assets*	*Long-term debt & put warrants*	*Stock-holders' equity*	*Additions to property, plant & equipment*
1997	$ 10,666	$ 28,880	$ 2,489	$ 19,295	$ 4,501
1996	$ 8,487	$ 23,735	$ 1,003	$ 16,872	$ 3,024
1995	$ 7,471	$ 17,504	$ 1,125	$ 12,140	$ 3,550
1994	$ 5,367	$ 13,816	$ 1,136	$ 9,267	$ 2,441
1993	$ 3,996	$ 11,344	$ 1,114	$ 7,500	$ 1,933
1992	$ 2,816	$ 8,089	$ 622	$ 5,445	$ 1,228
1991	$ 2,163	$ 6,292	$ 503	$ 4,418	$ 948
1990	$ 1,658	$ 5,376	$ 345	$ 3,592	$ 680
1989	$ 1,284	$ 3,994	$ 412	$ 2,549	$ 422
1988	$ 1,122	$ 3,550	$ 479	$ 2,080	$ 477

(In millions—except per share amounts)	*Net revenues*	*Cost of sales*	*Research & devel-opment*	*Operating income*	*Net income*	*Basic earnings per share*	*Diluted earnings per share*	*Dividends declared per share*
1997	$ 25,070	$ 9,945	$ 2,347	$ 9,887	$ 6,945	$ 4.25	$ 3.87	$ .115
1996	$ 20,847	$ 9,164	$ 1,808	$ 7,553	$ 5,157	$ 3.13	$ 2.90	$ .095
1995	$ 16,202	$ 7,811	$ 1,296	$ 5,252	$ 3,566	$ 2.16	$ 2.02	$ .075
1994	$ 11,521	$ 5,576	$ 1,111	$ 3,387	$ 2,288	$ 1.38	$ 1.31	$ .058
1993	$ 8,782	$ 3,252	$ 970	$ 3,392	$ 2,295	$ 1.37	$ 1.30	$ .050
1992	$ 5,844	$ 2,557	$ 780	$ 1,490	$ 1,067	$ .64	$ .62	$ .025
1991	$ 4,779	$ 2,316	$ 618	$ 1,080	$ 819	$ .51	$ .49	—
1990	$ 3,921	$ 1,930	$ 517	$ 858	$ 650	$ .42	$ .40	—
1989	$ 3,127	$ 1,721	$ 365	$ 557	$ 391	$ .27	$ .26	—
1988	$ 2,875	$ 1,506	$ 318	$ 594	$ 453	$ .33	$ .31	—

Management's discussion and analysis of financial condition and results of operations

Results of operations

Intel posted record net revenues in 1997, for the 11th consecutive year, rising by 20% from 1996 to 1997 and by 29% from 1995 to 1996. The growth in revenues from 1996 to 1997 was primarily due to higher volumes of the Pentium® microprocessor family (including processors with Intel's MMX™ media enhancement technology) and Pentium® Pro processors, and the ramp of the Pentium® II processors. The growth in revenues from 1995 to 1996 was driven primarily by higher volumes of the Pentium processor family, partially offset by lower processor prices. From 1995 to 1997, the increased revenues on microprocessors were partially offset by decreased revenues from sales of related board-level products, as sales of board-level products became less significant to the Company's business, and insignificant in 1997.

Higher volumes of chipset products also contributed toward the increase in revenues from 1995 to 1997 and helped enable the Pentium and Pentium Pro microprocessor ramps and the ongoing ramp of the Pentium II microprocessor. Revenues from embedded control products and networking and communications products also grew over this period. Revenues from flash memory products grew from 1995 to 1996 but declined from 1996 to 1997.

Cost of sales increased by 8.5% from 1996 to 1997 and by 17% from 1995 to 1996. While revenues increased substantially from 1996 to 1997 and from 1995 to 1996, growth in cost of sales was significantly less in both periods. The growth in cost of sales from 1996 to 1997 was driven by unit volume growth, costs related to the ramp of the 0.25-micron microprocessor manufacturing process and shifts in product mix, partially offset by factory efficiencies due to the increased volumes. Cost of sales in the second half of 1997 was negatively affected by the cost of purchased components in the Single Edge Contact ("SEC") cartridge used with the Pentium II processor. The increase in cost of sales from 1995 to 1996 was driven by unit volume growth, new factories commencing production, manufacturing process conversions and shifts in product mix. Cost of sales in the second half of 1996 was favorably affected by factory efficiencies from higher volumes.

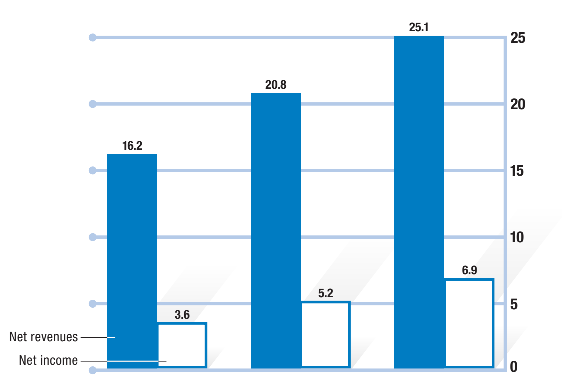
The gross margin percentage was 60% in 1997, compared to 56% in 1996 and 52% in 1995 as a result of the cost and revenue factors discussed above. However, for the second half of 1997, the gross margin percentage was 58%, compared to 60% in the second half of 1996, primarily due to the impact of the SEC cartridge and a weaker flash memory market segment in 1997. See "Outlook" for a discussion of gross margin expectations.

Sales of Pentium family microprocessors and related board-level products comprised a majority of the Company's revenues and gross margin during 1997. During 1996 and 1995, a majority of the Company's revenues and a substantial majority of its gross margin were derived from these products. Sales of Pentium Pro and Pentium II microprocessors became an increasing portion of the Company's revenues and gross margin in 1996 and a significant portion in 1997. The Intel486™ microprocessor family contributed significant but declining revenues and gross margin in 1995 and negligible revenues and gross margin in 1996.

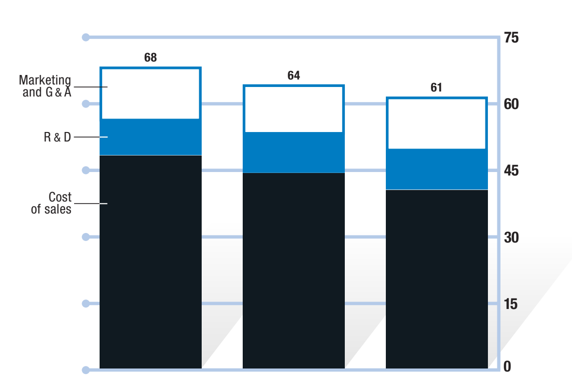
Research and development spending grew by 30% from 1996 to 1997 and 40% from 1995 to 1996, as the Company substantially increased its investments over this time period in strategic programs, particularly for the internal development of microprocessor products and related manufacturing technology. Increased spending for marketing programs (including media merchandising and the Company's Intel Inside® cooperative advertising program), other revenue-dependent expenses and expenses related to headcount in 1997 drove the 25% and 26% increases in marketing, general and administrative expenses from 1996 to 1997 and from 1995 to 1996, respectively.

Interest expense was essentially flat from 1996 to 1997, mainly due to lower interest capitalization, offset by lower average borrowing balances and interest rates in 1997. The decrease in interest expense from 1995 to 1996 was primarily due to lower average borrowing balances and interest rates in 1996.

Interest and other income increased by $393 million from 1996 to 1997, primarily due to higher average investment bal-



Revenues and income
(Dollars in billions)



Costs and expenses
(Percent of revenues)

Management's discussion and analysis of financial condition and results of operations

ances and higher gains on sales of equity investments. Although the Company had higher average investment balances in 1996 than in 1995, interest and other income decreased by $9 million from 1995 to 1996, primarily due to the offsetting effect of $118 million in unusual gains in 1995.

The Company's effective income tax rate decreased to 34.8% in 1997 compared to 35.0% and 36.8% in 1996 and 1995, respectively.

Financial condition

The Company's financial condition remains very strong. As of December 27, 1997, total cash, trading assets and short- and long-term investments totaled $11.8 billion, up from $9.3 billion at December 28, 1996. Cash generated from operating activities rose to $10.0 billion in 1997, compared to $8.7 billion and $4.0 billion in 1996 and 1995, respectively.

The Company used $6.9 billion in cash for investing activities during 1997, compared to $5.3 billion during 1996 and $2.7 billion during 1995, as operating activities generated significantly more cash during 1997. Capital expenditures totaled $4.5 billion in 1997, as the Company continued to invest in property, plant and equipment, primarily for microprocessor manufacturing capacity. The Company had committed approximately $3.3 billion for the construction or purchase of property, plant and equipment as of December 27, 1997. See "Outlook" for a discussion of capital expenditure expectations in 1998.

Inventory levels, particularly work in process and finished goods, increased significantly in 1997. This increase was primarily attributable to the ramp of the Pentium II processor and the related higher level of purchased components on the SEC cartridge. The decrease in accounts receivable in 1997 was mainly due to improved receivable collections and higher revenues in geographic regions with faster payment patterns. The Company's five largest customers accounted for approximately 39% of net revenues for 1997, and one customer accounted for 12% of revenues. No customers accounted for more than 10% of revenues in 1996 and 1995. At December 27, 1997, the five largest customers accounted for approximately 34% of net accounts receivable.

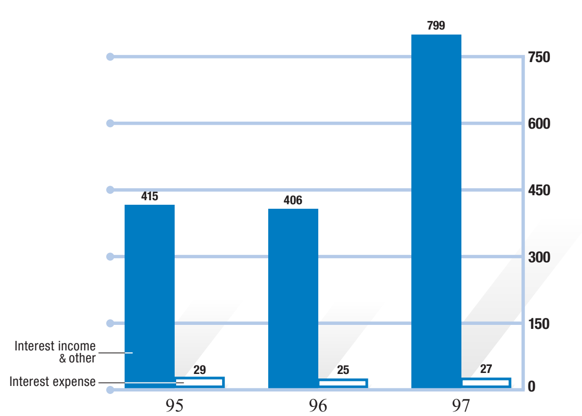
The Company used $3.2 billion for financing activities in 1997, compared to $773 million and $1.1 billion in 1996 and 1995, respectively. The major financing applications of cash in 1997 were for repurchase of 43.6 million shares of Common Stock for $3.4 billion and a $300 million repayment under a private reverse repurchase arrangement. The major financing applications of cash in 1996 and 1995 were for stock repurchases totaling $1.3 billion (including $108 million for exercised put warrants) and $1.0 billion, respectively. Financing sources of cash during 1997 included $357 million in proceeds from the sale of shares primarily pursuant to employee stock plans ($261 million in 1996 and $192 million in 1995). Financing sources in 1996 also included $300 million under the private reverse repurchase arrangement.

As part of its authorized stock repurchase program, the Company had outstanding put warrants at the end of 1997, with the potential obligation to buy back 26.3 million shares of its Common Stock at an aggregate price of $2.0 billion. The exercise price of these warrants ranged from $68 to $95 per share, with an average exercise price of $78 per share as of December 27, 1997.

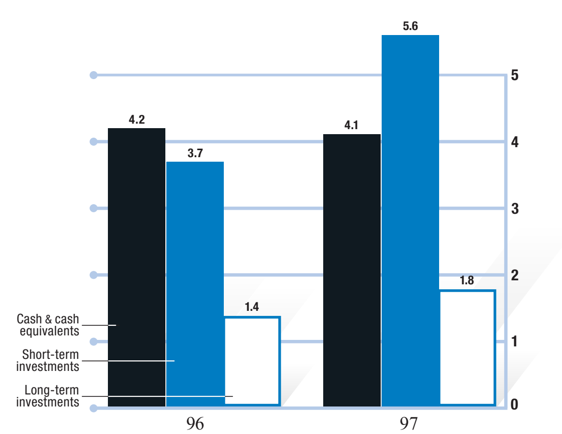
Other sources of liquidity include authorized commercial paper borrowings of $700 million. The Company also maintains the ability to issue an aggregate of approximately $1.4 billion in debt, equity and other securities under Securities and Exchange Commission shelf registration statements.

In January 1998, the Company acquired the outstanding shares of Chips and Technologies, Inc. of San Jose, California, for approximately $430 million.

On October 27, 1997, the Company and Digital Equipment Corporation ("Digital") announced that they have agreed to establish a broad-based business relationship. Under the agreement, Intel will purchase Digital's semiconductor operations, including facilities in Hudson, Massachusetts as well as development operations in Jerusalem, Israel and Austin, Texas for



Other income and expense
(Dollars in millions)



Cash and investments
(Dollars in billions)

Management's discussion and analysis of financial condition and results of operations

approximately $700 million. The agreement is subject to U.S. government review.

The Company believes that it has the financial resources needed to meet business requirements in the foreseeable future, including capital expenditures for the expansion of worldwide manufacturing capacity, working capital requirements, the potential put warrant obligation and the dividend program.

Financial market risks

The Company is exposed to financial market risks, including changes in interest rates, foreign currency exchange rates and marketable equity security prices. To mitigate these risks, the Company utilizes derivative financial instruments. The Company does not use derivative financial instruments for speculative or trading purposes.

The primary objective of the Company's investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, the returns on a majority of the Company's marketable investments in long-term fixed rate debt and equity securities are swapped to U.S. dollar LIBOR-based returns. A hypothetical 60 basis point increase in interest rates would result in an approximate $18 million decrease (less than 0.2%) in the fair value of the Company's available-for-sale securities.

The Company hedges currency risks of investments denominated in foreign currencies with foreign currency borrowings, currency forward contracts and currency interest rate swaps. Gains and losses on these foreign currency investments would generally be offset by corresponding losses and gains on the related hedging instruments, resulting in negligible net exposure to the Company.

A substantial majority of the Company's revenue, expense and capital purchasing activities are transacted in U.S. dollars. However, the Company does enter into these transactions in other currencies, primarily Japanese yen and certain other Asian and European currencies. To protect against reductions in value and the volatility of future cash flows caused by changes in foreign exchange rates, the Company has established revenue, expense and balance sheet hedging programs. Currency forward contracts and currency options are utilized in these hedging programs. The Company's hedging programs reduce, but do not always entirely eliminate, the impact of foreign currency exchange rate movements. An adverse change (defined as 20% in certain Asian currencies and 10% in all other currencies) in exchange rates would result in a decline in income before taxes of less than $20 million.

The Company is exposed to equity price risks on the marketable portion of equity securities included in its portfolio of investments entered into for the promotion of business and strategic objectives. These investments are generally in small capitalization stocks in the high-technology industry sector. The Company typically does not attempt to reduce or eliminate its market exposure on these securities. A 20% adverse change in equity prices would result in an approximate $75 million decrease in the fair value of the Company's available-for-sale securities.

All of the potential changes noted above are based on sensitivity analyses performed on the Company's financial positions at December 27, 1997. Actual results may differ materially.

Outlook

This outlook section contains a number of forward-looking statements, all of which are based on current expectations. Actual results may differ materially. These statements do not reflect the potential impact of any future mergers or acquisitions, except as noted below.

Intel expects that the total number of computers using Intel's Pentium family processors, sixth-generation processors (including Pentium II and Pentium Pro processors) and other semiconductor components sold worldwide will continue to grow in 1998. The Company's financial results are substantially dependent on sales of these microprocessors and other semiconductor components. Revenue is also a function of the mix of microprocessor types and speeds sold, as well as the mix of microprocessors and related purchased components, all of which are difficult to forecast. Because of the large price difference between types of microprocessors, this mix affects the average price Intel will realize and has a large impact on Intel's revenues. The Company's expectations regarding growth in the computing industry worldwide are subject to the impact of economic conditions in various geographic regions, including the Asia-Pacific region, which has recently been undergoing a currency and economic crisis.

Intel's strategy is to introduce ever higher performance microprocessors tailored for the different segments of the worldwide computing market. To implement this strategy, the Company plans to cultivate new businesses and continue to work with the software industry to develop compelling applications that can take advantage of this higher performance, thus driving demand toward the newer products in each computing market segment. In line with this strategy, the Company is seeking to develop higher performance microprocessors for each market segment, including servers, workstations, high-end business PCs, the basic PC and other product lines. The Company may continue to reduce microprocessor prices at such times as it deems appropriate in order to bring its technology to market within each relevant market segment.

The Company's gross margin varies depending on the mix of types and speeds of processors sold and the mix of microprocessors and related purchased components within a product family. The Company's most advanced product, the Pentium II processor, is packaged with purchased components in the SEC cartridge, and the inclusion of purchased components tends to increase

Management's discussion and analysis of financial condition and results of operations

absolute dollar margins but to lower the gross margin percentage. This increased volume of purchased components on the SEC cartridge is expected to reduce the gross margin percentage over the next several quarters from 59% in the fourth quarter of 1997. Various other factors (including unit volumes and costs, yield issues associated with production at factories, ramp of new technologies, excess or obsolete inventory, and mix of shipments of other semiconductors) will also continue to affect the amount of cost of sales and the variability of gross margin percentages. The Company currently expects that revenue and the gross margin percentage in the first quarter of 1998 will be adversely affected by weaker demand from original equipment manufacturers. Intel's primary goal is to get its advanced technology to the marketplace, and the Company sometimes implements strategies that increase dollar margins but lower margin percentages. These strategies include the SEC cartridge, as discussed above, and the Company's plans to grow in non-microprocessor areas that have the potential to expand computing and telecommunications capabilities, an example of which is the acquisition of Chips and Technologies, Inc.

The Company believes that over the long term the gross margin percentage will be 50% plus or minus a few points. In addition, from time to time, the Company may forecast a range of gross margin percentages for the coming quarter. Actual results may differ from these estimates.

The Company has expanded manufacturing capacity over the last few years and continues to expand capacity based on the assumed continued success of its strategy and the acceptance of its products in specific market segments. If the market demand does not continue to grow and move rapidly toward higher performance products in the various market segments, revenues and gross margin may be affected, the manufacturing capacity installed may be under-utilized, and capital spending may be slowed. Revenues and gross margin may also be affected if the Company does not add capacity fast enough to meet market demand. The Company expects that capital spending will increase to approximately $5.3 billion in 1998 to support significant expansion of worldwide manufacturing capacity. The Company's capital spending plan includes the acquisition of Digital's semiconductor facilities. This plan is dependent upon expectations regarding manufacturing efficiencies, delivery times of various machines and construction schedules for new facilities. Depreciation for 1998 is expected to be approximately $2.7 billion. Most of the increased depreciation would be included in cost of sales and research and development spending.

The industry in which Intel operates is characterized by very short product life cycles, and the Company's continued success is dependent on technological advances, including the development and implementation of new processes and new strategic products for specific market segments. As Intel considers it imperative to maintain a strong research and development program, spending for research and development in 1998 is expected to increase to approximately $2.8 billion. In addition, the Company expects the acquisition of Chips and Technologies, Inc. in 1998 to result in a one-time charge for in-process research and development of approximately $165 million in the first quarter. The Company will also continue spending to promote its products and to increase the value of its product brands. Based on current forecasts, spending for marketing, general and administrative expenses is also expected to increase in 1998.

The Company currently expects its tax rate to decrease to 34% for 1998 due to the settlement of federal tax audits and favorable resolution of significant state tax issues and tax matters in other countries. This estimate, based on current tax law and current estimate of earnings, excludes the effect of the one-time charge related to Chips and Technologies, Inc. and is subject to change.

In September 1997, the Federal Trade Commission ("FTC") staff notified Intel that the FTC has begun an investigation of the Company's business practices. To date, no allegations have been made, nor have any charges been filed. The Company has an aggressive program in place to make sure its business practices are in full compliance with federal laws in this area. Although neither the extent nor the outcome of this investigation can be determined at this time, management, including internal counsel, does not believe that the outcome will have a material adverse effect on the Company's financial position or overall trend in results of operations.

Like many other companies, the year 2000 computer issue creates risk for Intel. If internal systems do not correctly recognize date information when the year changes to 2000, there could be an adverse impact on the Company's operations. The Company has initiated a comprehensive project to prepare its computer systems for the year 2000 and plans to have changes to critical systems completed by the first quarter of 1999 to allow time for testing. The Company is also assessing the capability of its products sold to customers over a period of years to handle the year 2000 and has a plan in place to address product issues during 1998. Management believes that the likelihood of a material adverse impact due to problems with internal systems or products sold to customers is remote and expects that the cost of these projects over the next two years will not have a material effect on the Company's financial position or overall trends in results of operations. Intel is also contacting critical suppliers of products and services to determine that the suppliers' operations and the products and services they provide are year 2000 capable or to monitor their progress toward year 2000 capability. There can be no assurance that another company's failure to ensure year 2000 capability would not have an adverse effect on the Company.

Management's discussion and analysis of financial condition and results of operations

The Company's future results of operations and the other forward-looking statements contained in this outlook—in particular the statements regarding growth in the computing industry, gross margin, capital spending, depreciation, research and development, marketing and general and administrative expenses, the FTC investigation and the year 2000 issue—involve a number of risks and uncertainties. In addition to the factors discussed above, among the other factors that could cause actual results to differ materially are the following: changes in customer order patterns, including changes in customer and channel inventory levels; competitive factors, such as rival chip architectures and manufacturing technologies, competing software-compatible microprocessors and availability of other computing alternatives; timing of software industry product introductions; execution of the manufacturing ramp; the ability to successfully integrate and operate any acquired businesses; costs or other adverse effects associated with processors and other products containing errata (deviations from published specifications); risks associated with foreign operations; and litigation involving intellectual property, consumer and other issues.

Intel believes that it has the product offerings, facilities, personnel, and competitive and financial resources for continued business success, but future revenues, costs, margins and profits are all influenced by a number of factors, including those discussed above, all of which are inherently difficult to forecast.

Financial information by quarter (unaudited)

(In millions—except per share data)

1997 for quarter ended		*December 27*	*September 27*	*June 28*	*March 29*
Net revenues		$ 6,507	$ 6,155	$ 5,960	$ 6,448
Cost of sales		$ 2,691	$ 2,604	$ 2,343	$ 2,307
Net income		$ 1,743	$ 1,574	$ 1,645	$ 1,983
Basic earnings per share		$ 1.07	$ .96	$ 1.01	$ 1.21
Diluted earnings per share		$ .98	$ .88	$ .92	$ 1.10
Dividends per share [(A)]	Declared	$ .03	$ .03	$ .03	$ .025
	Paid	$ .03	$ .03	$ .025	$ .025
Market price range Common Stock [(B)]	High	$ 95.38	$100.50	$ 84.66	$ 82.38
	Low	$ 69.13	$ 69.53	$ 65.25	$ 65.19
Market price range Step-Up Warrants [(B)]	High	$ 74.69	$ 79.88	$ 64.16	$ 62.63
	Low	$ 48.38	$ 49.56	$ 45.31	$ 45.06

(In millions—except per share data)

1996 for quarter ended		*December 28*	*September 28*	*June 29*	*March 30*
Net revenues		$ 6,440	$ 5,142	$ 4,621	$ 4,644
Cost of sales		$ 2,392	$ 2,201	$ 2,150	$ 2,421
Net income		$ 1,910	$ 1,312	$ 1,041	$ 894
Basic earnings per share		$ 1.16	$ .80	$ .63	$ .54
Diluted earnings per share		$ 1.06	$ .74	$ .59	$ .51
Dividends per share [(A)]	Declared	$ .025	$ .025	$ .025	$ .020
	Paid	$ .025	$ .025	$ .020	$ .020
Market price range Common Stock [(B)]	High	$ 68.75	$ 48.69	$ 38.44	$ 30.50
	Low	$ 47.72	$ 34.50	$ 28.44	$ 25.00
Market price range Step-Up Warrants [(B)]	High	$ 49.19	$ 29.44	$ 19.66	$ 14.25
	Low	$ 28.38	$ 15.88	$ 12.00	$ 10.81

[(A)] *Intel plans to continue its dividend program. However, dividends are dependent on future earnings, capital requirements and financial condition.*

[(B)] *Intel's Common Stock (symbol INTC) trades on The Nasdaq Stock Market* and is quoted in the* Wall Street Journal *and other newspapers. Intel's 1998 Step-Up Warrants (symbol INTCW) trade on The Nasdaq Stock Market until their March 1998 expiration. Intel's Common Stock also trades on The Swiss Exchange. At December 27, 1997, there were approximately 173,000 registered holders of Common Stock. All stock and warrant prices are closing prices per The Nasdaq Stock Market.*

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Investor materials

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Intel's Common Stock trades on The Nasdaq Stock Market* under the symbol INTC.

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It has been more than 25 years since Intel introduced the world's first microprocessor, making technological history. The computer revolution that this technology enabled has changed the world. Today, Intel supplies the computing industry with the chips, boards, systems and software that are the "ingredients" of computer architecture. These products are used by industry members to create advanced computing systems. Intel's mission is to be the preeminent building block supplier to the new computing industry worldwide.

Principal products

Processor products. *Microprocessors,* also called central processing units (CPUs) or chips, are frequently described as the "brains" of a computer, because they control the central processing of data in personal computers (PCs), servers, workstations and other computers. *Motherboards* combine Intel microprocessors and chipsets to form the basic subsystem of a PC or server.

Computer enhancement products. *Chipsets* perform essential logic functions surrounding the CPU in computers based on Intel architecture processors. *Flash memory* provides easily reprogrammable memory for computers, mobile phones and many other products. Flash memory has the advantage of retaining data when the unit's power is turned off. *Embedded control chips* are designed to perform specific functions in products such as automobile engine and braking systems, hard disk drives, laser printers, input/output control modules, cellular phones and home appliances.

Networking and communications products enhance the capabilities of PC systems and networks, and make them easier to use and manage. These products are sold through reseller, retail and original equipment manufacturer (OEM) channels.

Major customers

Original equipment manufacturers of computer systems and peripherals. **PC users,** who buy Intel's PC enhancements, business communications products and networking products through reseller, retail and OEM channels. **Other manufacturers,** including makers of a wide range of industrial and telecommunications equipment.

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