

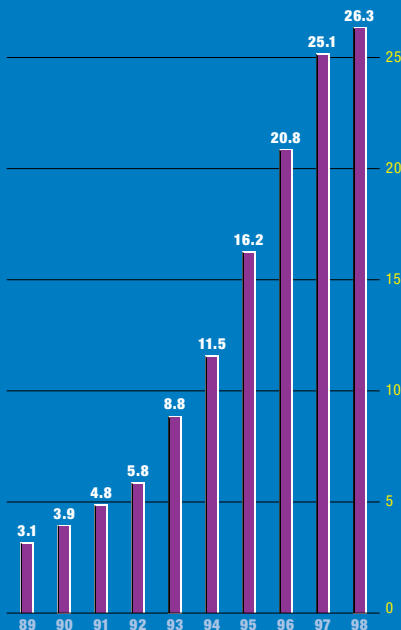


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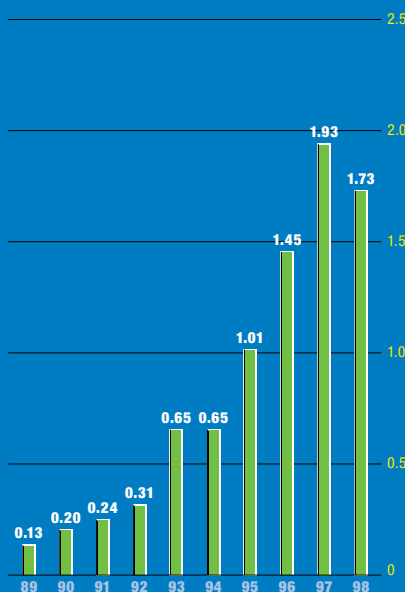
building a connected world

Facts and figures

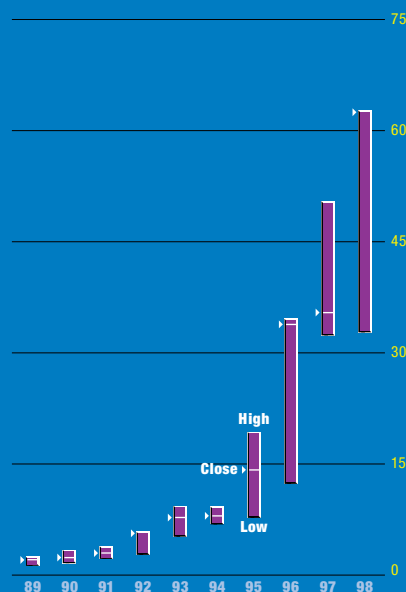
INTEL CORPORATION 1998



Net revenues
(Dollars in billions)

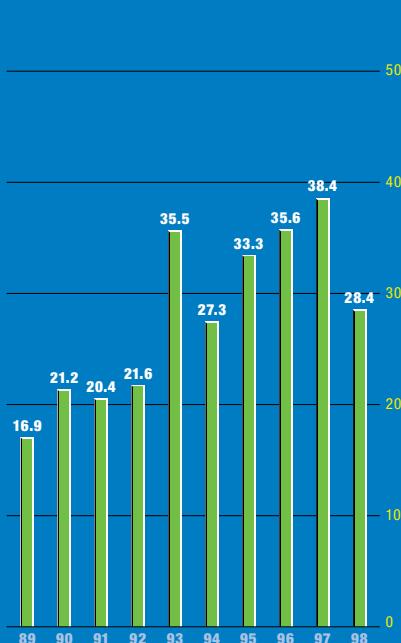


Diluted earnings per share
(Dollars, adjusted for stock splits)

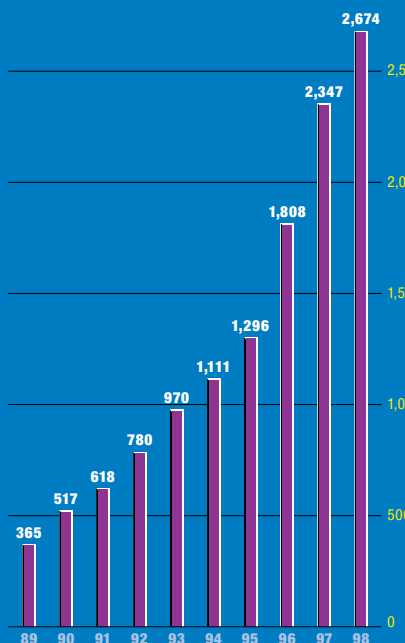


Stock price trading ranges by fiscal year
(Dollars, adjusted for stock splits)

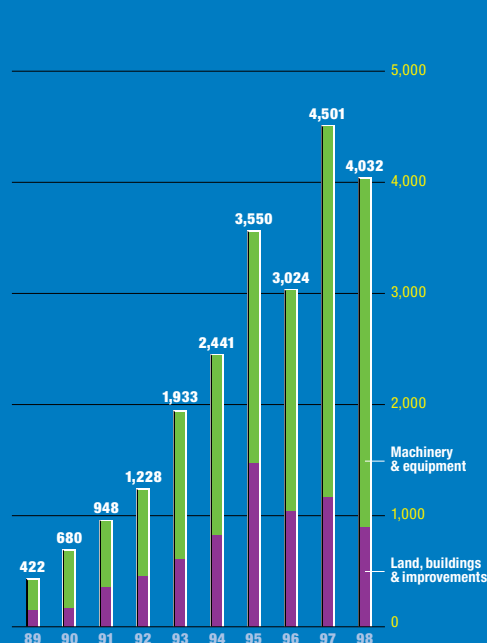
1998: challenges and



Return on average stockholders' equity
(Percent)



Research and development
(Dollars in millions)



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

Past performance does not guarantee future results.

Share and per share amounts shown have been adjusted for stock splits through April 1999, including the stock split declared in January 1999.

[†] Capital additions for 1998 included assets acquired from Digital Equipment Corporation.

To our stockholders



We faced extraordinary business conditions in 1998. Competition in the value PC market segment, inventory corrections among some of our large customers in the first half of the year and an economic slowdown in some parts of the world all took their toll. As a consequence,

our financial results in the first half of the year were not as strong as we would have liked. Revenues for the year were up 5%, with net income down 13% to \$6.1 billion. At the same time, beneath these choppy waters, we were undergoing a fundamental sea change in how we see our business. The Internet is transforming the nature of the computing industry. As a leading provider of key computing and communications building blocks, we play a central role in this revolution. We are confident that our actions have helped us ride out the turbulence of 1998, and we are excited about our strategic plans to help drive the development of an increasingly connected computing world.

New products for all levels. With hindsight, it's clear that we were caught off guard by the increase in demand for low-cost PCs. We were late in recognizing the emergence of this value PC market segment—and the competition took advantage of our delay. While our global position remains strong, we lost market share in the U.S. retail segment of the market (which is about 10% of the worldwide PC market). We have redoubled our efforts to regain that share, with focused product development.

In response to the evolving computing marketplace, it was clear that we had to drive our business in a new way. We developed a broad game plan that would enable us to participate in every level of the newly segmented computing market. We revamped our microprocessor lineup with new products created specifically for each computing segment:

an exciting sea change

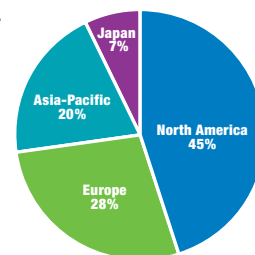
⇒ Our Intel® Celeron™ microprocessor, introduced in April and followed in August by an enhanced version, offers entry-level PC buyers good value and reliable Intel technology. By the end of 1998, it was the second-highest volume PC microprocessor in the world, second only to the Pentium® II microprocessor.

⇒ Our Pentium II microprocessor remains the heart of our business. Ideal for the performance desktop and entry-level servers and workstations, this powerful processor makes up the majority of units we sold worldwide in 1998.

⇒ The powerhouse Pentium® II Xeon™ microprocessor, introduced in August, is specifically designed for mid- and high-range servers and workstations. Manufacturers can benefit by designing systems to harness the power of multiple high-performance processors. Demand for servers and workstations is increasing, and within both of these segments, sales of systems based on Intel architecture are growing much faster than the overall segment.

Our segmentation strategy is designed to allow us to participate profitably in various segments of the computing market and to pursue new growth opportunities in the high-end server and workstation market segments. Supported by our strong branding program, which conveys the benefits of Intel technology and the attributes of the products at each level, our segmentation strategy is working as intended.

Adjusting to a cost-competitive environment. 1998 found us operating in a more cost competitive marketplace. We responded by setting aggressive new targets in cost management and manufacturing efficiency. With belt tightening in discretionary spending and some headcount reductions, we adjusted to an environment that demands leaner operations. We ended the year



1998 Geographic break-down of revenues
(Percent)

with headcount down 2% (excluding acquisitions) and our human resources employed in the areas of maximum return.

We also made great strides in manufacturing efficiency through a successful and rapid ramp to our new 0.25-micron process technology. With each new generation of our manufacturing process, the dimensions shrink on the finished chip, giving higher product yields as well as more powerful products.

In 1998, we also developed an innovative new packaging technology for our microprocessors, the Organic LAN Grid Array, that provides higher performance and versatility at lower cost for the final product. We are the only major chip maker using this packaging. We continue to invest in the state-of-the-art manufacturing facilities and R&D programs that make such innovations possible, spending \$4 billion for capital additions and \$2.7 billion for R&D in 1998.

The Internet drives an industry shift. Throughout the turbulence of the first half of the year, we were also adapting to a more fundamental shift in our business. Ten years ago, people bought PCs for personal productivity needs—spreadsheets, word processing and the like. Today, the number one reason people buy PCs is to get on the Internet. As the computing universe becomes connected, the demands on PCs and the entire computing infrastructure are expanding.

On a networked PC, every click of the mouse sets in motion a series of invisible and demanding tasks: compression and decompression of bulky downloads, encryption, virus scans and security checks, among others. These tasks have to be executed quickly and accurately behind the scenes, and they require powerful PCs. At the same time, behind the connected PCs is a large number of powerful servers, delivering data to the desktop and performing some of those compute-intensive functions. The number of servers is increasing as the Internet expands, providing a growing market segment for our products. We consider this opportunity so significant that more than half of Intel's microprocessor R&D investment is now committed to workstations and servers.

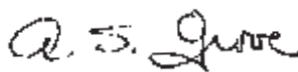
We also have a rapidly growing network products business, with software and hardware products designed to make it easier to connect and manage networked PCs for small businesses, large enterprises and home users. As part of our commitment to networking, we acquired Case Technology and Dayna Communications Inc. in 1997, and have entered into an agreement to acquire Shiva Corporation. These companies provide key technologies for improving Internet performance.

In addition to providing the powerful processors that are the key building blocks of the Internet and network products, we are engaging with other industry leaders in initiatives to expand Internet capabilities and product offerings. In 1998, our Corporate Business Development group made more than 100 new equity investments to help spur development of computer and Internet capabilities.

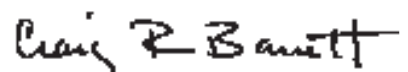
The Internet has stimulated the most intensely competitive cycle and development boom in the history of the computing industry. Being connected is now at the center of people's computing experience. The resulting opportunities have made our direction clear: to help drive the growth of the connected world. In 1999 and beyond, we will pursue our strategic intent to be a major force behind the Internet revolution.



Gordon E. Moore
Chairman Emeritus



Andrew S. Grove
Chairman



Craig R. Barrett
President and CEO

At the time of the Annual Meeting of Stockholders in May 1998, Craig Barrett was elected Chief Executive Officer of Intel Corporation, and Andy Grove was elected Chairman of the Board. Gordon Moore is now Chairman Emeritus. This is the latest phase of a management transition that has been under way for years and reflects our dedication to continuity in the executive office.

Our vision: getting to a

billion

connected computers worldwide.

The Internet boom is
transforming the world.
Here's what it
means for Intel.



the Internet:
it's PCs,
servers and
networks.



it's people

conne

The Internet is a global web of networks and servers. The servers manage the connections and hold the content that users see when they surf the Web; people plug in via networked PCs. In 1998, the number of users on the Internet skyrocketed, presenting a booming opportunity for Intel: our chips run more than 60% of Web servers and the vast majority of connected PCs.

The Internet connects people to people, businesses to people and businesses to businesses, all around the world. It's becoming as essential a communications infrastructure as the telephone—for businesses and individuals alike. By the end of 1998, Intel reached nearly \$1 billion per month in business over the Web since launching our online service in July.

cting



the Internet:
making it fast,
easy and cool.

■ Intel is

improving



We are helping to expand the capabilities of the PC platform and the Internet, attracting new users to the connected world:

- ⇒ Intel networking products help eliminate roadblocks on the way to the Web. Intel is a leading supplier of fast Ethernet connections and a range of easy-to-use hub and switch products that can get a small business connected and on the Internet the same day.
- ⇒ We are working with other industry leaders to make using PCs easier than ever. Intel-led initiatives are designed to take PCs from deep sleep to full power in five seconds and let users connect dozens of peripherals—from joysticks to speakers—through a single port.
- ⇒ From advanced 3D graphics and full-screen desktop video to compute-intensive compression and encryption that happen behind the scenes, powerful Intel chips deliver an exciting and satisfying computing experience.

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the Internet:
making the products
that make it work.
Intel is

deliver

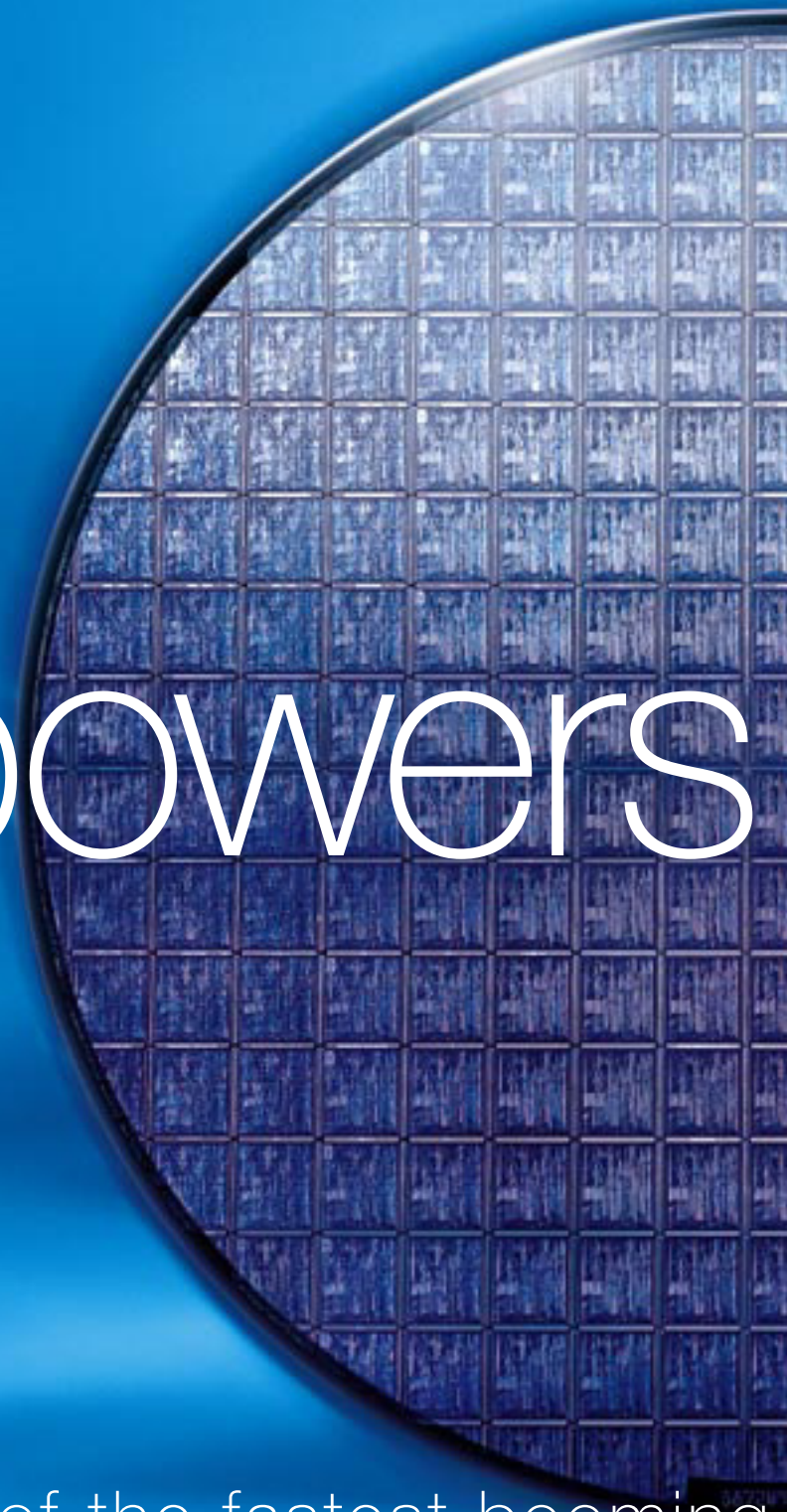




erining

Getting to a billion PCs connected around the world will require a whole lot of silicon. To meet the demand and remain competitive, we are increasing productivity and shortening manufacturing generations. With each advance in manufacturing, we squeeze more chips on every wafer and bring new products to market faster.

We've also developed new packaging technology that makes it easier to customize our chips for each computing market segment. With 1998 capital additions of \$4 billion and R&D of \$2.7 billion, we are committed to delivering the chips that power the boxes that build a connected world.



Intel powers

Intel is at the heart of the fastest booming
providing the building blocks of the Internet
we plan to deliver for PC users, customers



the Internet

communications medium in world history. By
and spurring efforts to make it more useful,
and stockholders well into the next century.

Financial summary 13

Consolidated statements of income 14

Consolidated balance sheets 15

Consolidated statements of cash flows 16

Consolidated statements of
stockholders' equity 17

Notes to consolidated
financial statements 18

Report of Ernst & Young LLP,
independent auditors 29

Management's discussion
and analysis of financial condition
and results of operations 30

Financial information by quarter 37

Ten Years Ended December 26, 1998

(In millions—except employees)	Employees at year-end (in thousands)	Net investment in property, plant & equipment	Total assets	Long-term debt & put warrants	Stock- holders' equity	Additions to property, plant & equipment [†]
1998	64.5	\$11,609	\$31,471	\$ 903	\$23,377	\$ 4,032
1997	63.7	\$10,666	\$28,880	\$ 2,489	\$19,295	\$ 4,501
1996	48.5	\$ 8,487	\$23,735	\$ 1,003	\$16,872	\$ 3,024
1995	41.6	\$ 7,471	\$17,504	\$ 1,125	\$12,140	\$ 3,550
1994	32.6	\$ 5,367	\$13,816	\$ 1,136	\$ 9,267	\$ 2,441
1993	29.5	\$ 3,996	\$11,344	\$ 1,114	\$ 7,500	\$ 1,933
1992	25.8	\$ 2,816	\$ 8,089	\$ 622	\$ 5,445	\$ 1,228
1991	24.6	\$ 2,163	\$ 6,292	\$ 503	\$ 4,418	\$ 948
1990	23.9	\$ 1,658	\$ 5,376	\$ 345	\$ 3,592	\$ 680
1989	21.7	\$ 1,284	\$ 3,994	\$ 412	\$ 2,549	\$ 422

INTEL CORPORATION 1998

(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	Dividends paid per share	Weighted average diluted shares outstanding
1998	\$26,273	\$12,144	\$ 2,674	\$ 8,379	\$ 6,068	\$ 1.82	\$ 1.73	\$.050	\$.065	3,517
1997	\$25,070	\$ 9,945	\$ 2,347	\$ 9,887	\$ 6,945	\$ 2.12	\$ 1.93	\$.058	\$.055	3,590
1996	\$20,847	\$ 9,164	\$ 1,808	\$ 7,553	\$ 5,157	\$ 1.57	\$ 1.45	\$.048	\$.045	3,551
1995	\$16,202	\$ 7,811	\$ 1,296	\$ 5,252	\$ 3,566	\$ 1.08	\$ 1.01	\$.038	\$.035	3,536
1994	\$11,521	\$ 5,576	\$ 1,111	\$ 3,387	\$ 2,288	\$.69	\$.65	\$.029	\$.028	3,496
1993	\$ 8,782	\$ 3,252	\$ 970	\$ 3,392	\$ 2,295	\$.69	\$.65	\$.025	\$.025	3,528
1992	\$ 5,844	\$ 2,557	\$ 780	\$ 1,490	\$ 1,067	\$.32	\$.31	\$.013	\$.006	3,436
1991	\$ 4,779	\$ 2,316	\$ 618	\$ 1,080	\$ 819	\$.25	\$.24	—	—	3,344
1990	\$ 3,921	\$ 1,930	\$ 517	\$ 858	\$ 650	\$.21	\$.20	—	—	3,247
1989	\$ 3,127	\$ 1,721	\$ 365	\$ 557	\$ 391	\$.13	\$.13	—	—	3,020

Share and per share amounts shown have been adjusted for stock splits through April 1999, including the stock split declared in January 1999.

[†]Additions to property, plant and equipment in 1998 included \$475 million for capital assets acquired from Digital Equipment Corporation.

Three years ended December 26, 1998
(In millions—except per share amounts)

	1998	1997	1996
Net revenues	\$26,273	\$25,070	\$20,847
Cost of sales	12,144	9,945	9,164
Research and development	2,509	2,347	1,808
Marketing, general and administrative	3,076	2,891	2,322
Purchased in-process research and development	165	—	—
Operating costs and expenses	17,894	15,183	13,294
Operating income	8,379	9,887	7,553
Interest expense	(34)	(27)	(25)
Interest income and other, net	792	799	406
Income before taxes	9,137	10,659	7,934
Provision for taxes	3,069	3,714	2,777
Net income	\$ 6,068	\$ 6,945	\$ 5,157
Basic earnings per common share	\$ 1.82	\$ 2.12	\$ 1.57
Diluted earnings per common share	\$ 1.73	\$ 1.93	\$ 1.45
Weighted average common shares outstanding	3,336	3,271	3,290
Dilutive effect of:			
Employee stock options	159	204	187
1998 Step-Up Warrants	22	115	74
Weighted average common shares outstanding, assuming dilution	3,517	3,590	3,551

See accompanying notes.

Consolidated balance sheets

15

December 26, 1998 and December 27, 1997
(In millions—except per share amounts)

	1998	1997
Assets		
Current assets:		
Cash and cash equivalents.....	\$ 2,038	\$ 4,102
Short-term investments.....	5,272	5,630
Trading assets.....	316	195
Accounts receivable, net of allowance for doubtful accounts of \$62 (\$65 in 1997).....	3,527	3,438
Inventories.....	1,582	1,697
Deferred tax assets.....	618	676
Other current assets.....	122	129
Total current assets	13,475	15,867
Property, plant and equipment:		
Land and buildings.....	6,297	5,113
Machinery and equipment.....	13,149	10,577
Construction in progress.....	1,622	2,437
	21,068	18,127
Less accumulated depreciation.....	9,459	7,461
Property, plant and equipment, net	11,609	10,666
Long-term investments	5,365	1,839
Other assets	1,022	508
Total assets	\$31,471	\$28,880
Liabilities and stockholders' equity		
Current liabilities:		
Short-term debt.....	\$ 159	\$ 212
Long-term debt redeemable within one year.....	—	110
Accounts payable.....	1,244	1,407
Accrued compensation and benefits.....	1,285	1,268
Deferred income on shipments to distributors.....	606	516
Accrued advertising.....	458	500
Other accrued liabilities.....	1,094	842
Income taxes payable.....	958	1,165
Total current liabilities	5,804	6,020
Long-term debt	702	448
Deferred tax liabilities	1,387	1,076
Put warrants	201	2,041
Commitments and contingencies		
Stockholders' equity:		
Preferred Stock, \$.001 par value, 50 shares authorized; none issued.....	—	—
Common Stock, \$.001 par value, 4,500 shares authorized; 3,315 issued and outstanding (3,256 in 1997) and capital in excess of par value.....	4,822	3,311
Retained earnings.....	17,952	15,926
Accumulated other comprehensive income.....	603	58
Total stockholders' equity	23,377	19,295
Total liabilities and stockholders' equity	\$31,471	\$28,880

See accompanying notes.

16 Consolidated statements of cash flows

INTEL CORPORATION 1998

Three years ended December 26, 1998
(In millions)

	1998	1997	1996
Cash and cash equivalents, beginning of year	\$ 4,102	\$ 4,165	\$ 1,463
Cash flows provided by (used for) operating activities:			
Net income	6,068	6,945	5,157
Adjustments to reconcile net income to net cash provided by (used for) operating activities:			
Depreciation	2,807	2,192	1,888
Net loss on retirements of property, plant and equipment	282	130	120
Deferred taxes	77	6	179
Purchased in-process research and development	165	—	—
Changes in assets and liabilities:			
Accounts receivable	(38)	285	(607)
Inventories	167	(404)	711
Accounts payable	(180)	438	105
Accrued compensation and benefits	17	140	370
Income taxes payable	(211)	179	185
Tax benefit from employee stock plans	415	224	196
Other assets and liabilities	(378)	(127)	439
Total adjustments	3,123	3,063	3,586
Net cash provided by operating activities	9,191	10,008	8,743
Cash flows provided by (used for) investing activities:			
Additions to property, plant and equipment	(3,557)	(4,501)	(3,024)
Purchase of Chips and Technologies, Inc., net of cash acquired	(321)	—	—
Purchase of Digital Equipment Corporation semiconductor operations	(585)	—	—
Purchases of available-for-sale investments	(10,925)	(9,224)	(4,683)
Sales of available-for-sale investments	201	153	225
Maturities and other changes in available-for-sale investments	8,681	6,713	2,214
Net cash (used for) investing activities	(6,506)	(6,859)	(5,268)
Cash flows provided by (used for) financing activities:			
(Decrease) increase in short-term debt, net	(83)	(177)	43
Additions to long-term debt	169	172	317
Retirement of long-term debt	—	(300)	—
Proceeds from sales of shares through employee stock plans and other	507	317	257
Proceeds from exercise of 1998 Step-Up Warrants	1,620	40	4
Proceeds from sales of put warrants	40	288	56
Repurchase and retirement of Common Stock	(6,785)	(3,372)	(1,302)
Payment of dividends to stockholders	(217)	(180)	(148)
Net cash (used for) financing activities	(4,749)	(3,212)	(773)
Net (decrease) increase in cash and cash equivalents	(2,064)	(63)	2,702
Cash and cash equivalents, end of year	\$ 2,038	\$ 4,102	\$ 4,165
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 40	\$ 37	\$ 51
Income taxes	\$ 2,784	\$ 3,305	\$ 2,217

See accompanying notes.

Consolidated statements of stockholders' equity

Three years ended December 26, 1998 (In millions—except per share amounts)	Common Stock and capital in excess of par value		Retained earnings	Accumulated other com- prehensive income	Total
	Number of shares	Amount			
Balance at December 30, 1995	3,286	\$ 2,583	\$ 9,505	\$ 52	\$12,140
Components of comprehensive income:					
Net income	—	—	5,157	—	5,157
Change in unrealized gain on available-for-sale investments	—	—	—	70	70
Total comprehensive income					5,227
Proceeds from sales of shares through employee stock plans, tax benefit of \$196 and other	65	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	(68)	(269)	(925)	—	(1,194)
Cash dividends declared (\$.048 per share)	—	—	(156)	—	(156)
Balance at December 28, 1996	3,283	2,897	13,853	122	16,872
Components of comprehensive income:					
Net income	—	—	6,945	—	6,945
Change in unrealized gain on available-for-sale investments	—	—	—	(64)	(64)
Total comprehensive income					6,881
Proceeds from sales of shares through employee stock plans, tax benefit of \$224 and other	61	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	(88)	(311)	(3,061)	—	(3,372)
Cash dividends declared (\$.058 per share)	—	—	(188)	—	(188)
Balance at December 27, 1997	3,256	3,311	15,926	58	19,295
Components of comprehensive income:					
Net income	—	—	6,068	—	6,068
Change in unrealized gain on available-for-sale investments	—	—	—	545	545
Total comprehensive income					6,613
Proceeds from sales of shares through employee stock plans, tax benefit of \$415 and other	66	922	—	—	922
Proceeds from exercise of 1998 Step-Up Warrants	155	1,620	—	—	1,620
Proceeds from sales of put warrants	—	40	—	—	40
Reclassification of put warrant obligation, net	—	53	588	—	641
Repurchase and retirement of Common Stock	(162)	(1,124)	(4,462)	—	(5,586)
Cash dividends declared (\$.050 per share)	—	—	(168)	—	(168)
Balance at December 26, 1998	3,315	\$ 4,822	\$17,952	\$ 603	\$23,377

See accompanying notes.

Accounting policies

Fiscal year. Intel Corporation ("Intel" or "the Company") has a fiscal year that ends the last Saturday in December. Fiscal years 1998, 1997 and 1996, each 52-week years, ended on December 26, 27 and 28, 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 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's policy is to protect the value of its investment portfolio and to minimize principal risk by earning returns based on current interest rates. The Company enters into certain equity investments for the promotion of business and strategic objectives, and typically does not attempt to reduce or eliminate the inherent market risks on these investments. 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. 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. Net gains on the trading asset portfolio were \$66 million, \$37 million and \$12 million in 1998, 1997 and 1996, respectively.

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 also uses derivatives to create synthetic instruments, for example, buying and selling put and call options on the same underlying security, to generate money market like returns with a similar level of risk. The Company does not use derivative financial instruments for speculative or trading purposes. The Company's accounting policies for these instruments are based on whether they meet the Company's criteria for designation 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 are 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)	1998	1997
Raw materials	\$ 206	\$ 255
Work in process	795	928
Finished goods	581	514
Total	\$ 1,582	\$ 1,697

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

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 revenues are recognized. All other advertising costs are expensed as incurred. Advertising expense was \$1.3 billion, \$1.2 billion and \$974 million in 1998, 1997 and 1996, 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. Interest expense capitalized as a component of construction costs was \$6 million, \$9 million and \$33 million for 1998, 1997 and 1996, respectively.

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. For portions of 1998, certain of the Company's stock options were excluded from the calculation of diluted earnings per share because they were antidilutive, but these options could be dilutive in the future.

Stock distribution. On January 27, 1999, the Company announced a two-for-one stock split in the form of a special stock distribution payable April 11, 1999 to stockholders of record as of March 23, 1999. 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 effects of these splits.

Reclassifications. Certain amounts reported in previous years have been reclassified to conform to the 1998 presentation.

Recent accounting pronouncements. The Company intends to adopt Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as of the beginning of its fiscal year 2000. The Standard will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The change in a derivative's fair value related to the ineffective portion of a hedge, if any, will be immediately recognized in earnings. The effect of adopting the Standard is currently being evaluated but is not expected to have a material effect on the Company's financial position or overall trends in results of operations.

Common Stock

1998 Step-Up Warrants. In 1993, the Company issued 160 million 1998 Step-Up Warrants to purchase 160 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 \$8.9375 per share of Common Stock, subject to annual increases to a maximum price of \$10.4375 per share effective in March 1997. Between December 27, 1997 and March 14, 1998, approximately 155 million Warrants were exercised, and shares of Common Stock were issued for proceeds of \$1.6 billion. The expiration date of these Warrants was March 14, 1998.

Stock repurchase program. The Company has an ongoing authorization, as amended, from the Board of Directors to repurchase up to 760 million shares of Intel's Common Stock in open market or negotiated transactions. During 1998, the Company repurchased 161.7 million shares of Common Stock at a cost of \$6.8 billion. As of December 26, 1998, the Company had repurchased and retired approximately 588.6 million shares at a cost of \$13.6 billion since the program began in 1990. As of December 26, 1998, after allowing for 5 million shares to cover outstanding put warrants, 166.4 million shares remained available under the repurchase authorization.

Put warrants

In a series of private placements from 1991 through 1998, 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. Activity during the past three years is summarized as follows:

(In millions)	Cumulative net premium received	Put warrants outstanding	
		Number of warrants	Potential obligation
December 30, 1995	\$ 279	48.0	\$ 725
Sales	56	36.0	603
Exercises	—	(7.2)	(108)
Expirations	—	(58.8)	(945)
December 28, 1996	335	18.0	275
Sales	288	92.6	3,525
Expirations	—	(58.0)	(1,759)
December 27, 1997	623	52.6	2,041
Sales	40	15.0	588
Exercises	—	(30.0)	(1,199)
Expirations	—	(32.6)	(1,229)
December 26, 1998	\$ 663	5.0	\$ 201

The amount related to Intel's potential repurchase obligation has been reclassified from stockholders' equity to put warrants. The 5 million put warrants outstanding at December 26, 1998 expire on various dates in January and February 1999 and have exercise prices ranging from \$40 to \$41 per share, with an average exercise price of \$40 per share. There is no significant effect on diluted earnings per share for the periods presented.

Borrowings

Short-term debt. Non-interest-bearing short-term debt at fiscal year-ends was as follows:

(In millions)	1998	1997
Borrowed under lines of credit	\$ 10	\$ 32
Drafts payable	149	180
Total	\$ 159	\$ 212

The Company also borrows under commercial paper programs. Maximum borrowings under commercial paper programs reached \$325 million during 1998 and \$175 million during 1997. 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)	1998	1997
Payable in U.S. dollars:		
AFICA Bonds due 2013 at 3.9%–4.25%	\$ 110	\$ 110
Other U.S. dollar debt	5	6
Payable in other currencies:		
Irish punt due 2000–2027 at 5%–12%	541	396
Greek drachma due 2001	46	46
Subtotal	702	558
Less long-term debt redeemable within one year	—	(110)
Total	\$ 702	\$ 448

The Company has guaranteed repayment of principal and interest on the AFICA Bonds issued by the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA"). During 1998, the bonds were repriced and a portion remarketed, with interest rates effective through 2003 of 4.25% on the \$80 million of Series A bonds and 3.90% on the \$30 million of Series B bonds. The bonds are adjustable and redeemable at the option of either the Company or the bondholder every five years through 2013 and are next adjustable and redeemable in 2003. The additional and the existing Irish punt borrowings were made in connection with the financing of manufacturing facilities 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.

Under shelf registration statements filed with the Securities and Exchange Commission, Intel 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 \$1.4 billion in additional securities under effective registration statements.

As of December 26, 1998, aggregate debt maturities were as follows: 2000—\$9 million; 2001—\$57 million; 2002—\$22 million; 2003—\$130 million; and thereafter—\$484 million.

Investments

The returns on a majority of the Company's marketable investments in long-term fixed rate debt and certain 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").

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 26, 1998, investments were placed with approximately 185 different counterparties.

Investments at December 26, 1998 were as follows:

(In millions)	Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. government securities	\$ 2,824	\$ —	\$ (11)	\$ 2,813
Commercial paper	2,694	5	(2)	2,697
Floating rate notes	1,273	2	(2)	1,273
Corporate bonds	1,153	51	(17)	1,187
Bank time deposits	1,135	1	(1)	1,135
Loan participations	625	—	—	625
Repurchase agreements	124	—	—	124
Securities of foreign governments	36	1	(1)	36
Other debt securities	160	—	—	160
Total debt securities	10,024	60	(34)	10,050
Hedged equity	100	—	(2)	98
Marketable strategic equity securities	822	979	(44)	1,757
Preferred stock and other equity	140	1	—	141
Total equity securities	1,062	980	(46)	1,996
Options creating synthetic money market instruments	474	—	—	474
Swaps hedging investments in debt securities	—	19	(52)	(33)
Swaps hedging investments in equity securities	—	2	—	2
Currency forward contracts hedging investments in debt securities	—	2	(4)	(2)
Total available-for-sale securities	11,560	1,063	(136)	12,487
Less amounts classified as cash equivalents	(1,850)	—	—	(1,850)
Total investments	\$ 9,710	\$ 1,063	\$ (136)	\$10,637

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 time 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
Marketable strategic equity securities	279	130	(34)	375
Preferred stock and other equity	341	1	(7)	335
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

Available-for-sale securities with a fair value at the date of sale of \$227 million, \$153 million and \$225 million were sold in 1998, 1997 and 1996, respectively. The gross realized gains on these sales totaled \$185 million, \$106 million and \$7 million, respectively.

The amortized cost and estimated fair value of investments in debt securities at December 26, 1998, by contractual maturity, were as follows:

(In millions)	Cost	Estimated fair value
Due in 1 year or less	\$ 6,412	\$ 6,436
Due in 1–2 years	3,097	3,099
Due in 2–5 years	65	65
Due after 5 years	450	450
Total investments in debt securities	\$10,024	\$10,050

Derivative financial instruments

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

(In millions)	1998	1997
Swaps hedging investments in debt securities	\$ 2,526	\$ 2,017
Swaps hedging investments in equity securities	\$ 100	\$ 604
Swaps hedging debt	\$ 156	\$ 156
Currency forward contracts	\$ 830	\$ 1,724
Currency options	\$ —	\$ 55
Options creating synthetic money market instruments	\$ 2,086	\$ —

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 derivative financial instruments 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 generally remain in effect until expiration.

Weighted average pay and receive rates, average maturities and range of maturities on swaps at December 26, 1998 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	5.4%	5.1%	0.5 years	0–2 years
Swaps hedging investments in foreign currency debt securities	5.5%	5.5%	0.7 years	0–2 years
Swaps hedging investments in equity securities	N/A	5.8%	1.0 years	0–1 years
Swaps hedging debt	5.6%	5.7%	4.1 years	2–5 years

Note: Pay and receive rates are based on the reset rates that were in effect at December 26, 1998.

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.

Fair values of financial instruments

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

(In millions)	1998		1997	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Cash and cash equivalents	\$ 2,038	\$ 2,038	\$ 4,102	\$ 4,102
Short-term investments	\$ 4,821	\$ 4,821	\$ 5,561	\$ 5,561
Trading assets	\$ 316	\$ 316	\$ 195	\$ 195
Long-term investments	\$ 5,375	\$ 5,375	\$ 1,821	\$ 1,821
Non-marketable instruments	\$ 571	\$ 716	\$ 387	\$ 497
Options creating synthetic money market instruments	\$ 474	\$ 474	\$ —	\$ —
Swaps hedging investments in debt securities	\$ (33)	\$ (33)	\$ 64	\$ 64
Swaps hedging investments in equity securities	\$ 2	\$ 2	\$ 8	\$ 8
Short-term debt	\$ (159)	\$ (159)	\$ (212)	\$ (212)
Long-term debt redeemable within one year	\$ —	\$ —	\$ (110)	\$ (109)
Long-term debt	\$ (702)	\$ (696)	\$ (448)	\$ (448)
Swaps hedging debt	\$ —	\$ 1	\$ —	\$ (1)
Currency forward contracts	\$ (1)	\$ (1)	\$ 26	\$ 28
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 42% of net revenues for 1998. At December 26, 1998, these customers accounted for approximately 39% of net accounts receivable.

The Company endeavors to keep pace with the evolving computing 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 the Company's end customers and geographic sales areas. Intel performs ongoing credit evaluations of its customers' financial condition and requires collateral as deemed necessary.

Interest income and other

(In millions)	1998	1997	1996
Interest income	\$ 593	\$ 562	\$ 364
Foreign currency gains	11	63	26
Other income, net	188	174	16
Total	\$ 792	\$ 799	\$ 406

Other income for 1998 and 1997 included approximately \$185 and \$106 million, respectively, from sales of a portion of the Company's investments in marketable strategic equity securities.

Comprehensive income

The Company adopted SFAS No. 130, "Reporting Comprehensive Income," at the beginning of fiscal 1998. The adoption had no impact on net income or total stockholders' equity. Comprehensive income consists of net income and other comprehensive income.

The components of other comprehensive income and related tax effects were as follows:

(In millions)	1998	1997	1996
Gains on investments during the year, net of tax of \$(357), \$(4) and \$(37) in 1998, 1997 and 1996, respectively	\$ 665	\$ 5	\$ 75
Less: adjustment for gains included in net income, net of tax of \$65, \$37 and \$2 in 1998, 1997 and 1996, respectively	(120)	(69)	(5)
Other comprehensive income	\$ 545	\$ (64)	\$ 70

Accumulated other comprehensive income presented in the accompanying consolidated balance sheets consists of the accumulated net unrealized gain on available-for-sale investments.

Provision for taxes

Income before taxes and the provision for taxes consisted of the following:

(In millions)	1998	1997	1996
Income before taxes:			
U.S.	\$ 6,677	\$ 8,033	\$ 5,515
Foreign	2,460	2,626	2,419
Total income before taxes	\$ 9,137	\$10,659	\$ 7,934
Provision for taxes:			
Federal:			
Current	\$ 2,321	\$ 2,930	\$ 2,046
Deferred	145	30	8
	2,466	2,960	2,054
State:			
Current	320	384	286
Foreign:			
Current	351	394	266
Deferred	(68)	(24)	171
	283	370	437
Total provision for taxes	\$ 3,069	\$ 3,714	\$ 2,777
Effective tax rate	33.6%	34.8%	35.0%

The tax benefit associated with dispositions from employee stock plans reduced taxes currently payable for 1998 by \$415 million (\$224 million and \$196 million for 1997 and 1996, 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)	1998	1997	1996
Computed expected tax	\$ 3,198	\$ 3,731	\$ 2,777
State taxes, net of federal benefits	208	249	186
Foreign income taxed at different rates	(339)	(111)	(127)
Other	2	(155)	(59)
Provision for taxes	\$ 3,069	\$ 3,714	\$ 2,777

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)	1998	1997
Deferred tax assets		
Accrued compensation and benefits	\$ 117	\$ 76
Deferred income	181	200
Inventory valuation and related reserves	106	163
Interest and taxes	52	49
Other, net	162	188
	<u>618</u>	<u>676</u>
Deferred tax liabilities		
Depreciation	(911)	(882)
Unremitted earnings of certain subsidiaries	(152)	(162)
Unrealized gain on investments	(324)	(32)
	<u>(1,387)</u>	<u>(1,076)</u>
Net deferred tax (liability)	\$ (769)	\$ (400)

U.S. income taxes were not provided for on a cumulative total of approximately \$2.2 billion of undistributed earnings for certain non-U.S. subsidiaries. The Company intends to reinvest these earnings indefinitely in operations outside the United States.

During 1998, the Company settled all tax and related interest for years 1991 through 1996 with the Internal Revenue Service ("IRS"). The settlement did not result in a material effect on the Company's 1998 financial statements. Years after 1996 are open to examination by the IRS. Management believes that adequate amounts of tax and related interest and penalties, if any, have been provided for any adjustments that may result for these years.

Employee benefit plans

Stock option plans. Intel has a 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. The Company also has a stock option plan under which stock options may be granted to employees other than officers and directors. The Company's Executive Long-Term Stock Option Plan, under which certain key employees, including officers, have been granted stock options, terminated in September 1998. Although this termination will not affect options granted prior to this date, no further grants may be made under this plan. Under all of the plans, the option exercise price is equal to the fair market value of Intel Common Stock at the date of grant.

Options currently expire no later than 10 years from the grant date, and generally vest within 5 years. Proceeds received by the Company from exercises are credited to Common Stock and capital in excess of par value. Additional information with respect to stock option plan activity is as follows:

(In millions)	Shares available for options	Outstanding options	
		Number of shares	Weighted average exercise price
December 30, 1995	173.8	342.0	\$ 5.30
Grants	(53.4)	53.4	\$ 17.28
Exercises	—	(47.4)	\$ 2.47
Cancellations	10.2	(10.2)	\$ 8.53
December 28, 1996	130.6	337.8	\$ 7.49
Additional shares reserved	260.0	—	—
Grants	(63.0)	63.0	\$ 36.23
Exercises	—	(47.2)	\$ 3.06
Cancellations	8.8	(8.8)	\$ 16.38
December 27, 1997	336.4	344.8	\$ 13.12
Grants	(48.0)	48.0	\$ 38.35
Exercises	—	(63.0)	\$ 4.59
Cancellations	17.3	(17.3)	\$ 23.64
Lapsed under terminated plans	(38.5)	—	—
December 26, 1998	267.2	312.5	\$ 18.13
Options exercisable at:			
December 28, 1996		114.5	\$ 2.86
December 27, 1997		115.2	\$ 3.66
December 26, 1998		103.8	\$ 6.11

The range of option exercise prices for options outstanding at December 26, 1998 was \$1.46 to \$60.80. The range of exercise prices for options is wide, primarily due to the increasing price of the Company's stock over the period in which the option grants were awarded.

The following tables summarize information about options outstanding at December 26, 1998:

Range of exercise prices	Outstanding options		
	Number of shares (in millions)	Weighted average contractual life (in years)	Weighted average exercise price
\$1.46–\$5.55	55.8	2.2	\$ 2.83
\$5.62–\$11.10	70.2	4.9	\$ 7.18
\$11.42–\$34.75	89.2	6.9	\$ 15.16
\$34.85–\$60.80	97.3	8.8	\$ 37.51
Total	312.5	6.2	\$ 18.13

Range of exercise prices	Exercisable options		
	Number of shares (in millions)	Weighted average exercise price	
\$1.46–\$5.55	55.8	\$ 2.83	
\$5.62–\$11.10	37.6	\$ 6.16	
\$11.42–\$34.75	7.0	\$ 16.82	
\$34.85–\$60.80	3.4	\$ 37.53	
Total	103.8	\$ 6.11	

These options will expire if not exercised at specific dates ranging from January 1999 to December 2008. Option exercise prices for options exercised during the three-year period ended December 26, 1998 ranged from \$0.78 to \$48.97.

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 472 million shares authorized to be issued under the plan, 79.7 million shares remained available for issuance at December 26, 1998. Employees purchased 6.3 million shares in 1998 (9 million in 1997 and 14 million in 1996) for \$229 million (\$191 million and \$140 million in 1997 and 1996, 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 1998, 1997 and 1996 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	1998	1997	1996
Expected life (in years)	6.5	6.5	6.5
Risk-free interest rate	5.3%	6.6%	6.5%
Volatility	.36	.36	.36
Dividend yield	.2%	.1%	.2%

Stock Participation Plan shares	1998	1997	1996
Expected life (in years)	.5	.5	.5
Risk-free interest rate	5.2%	5.3%	5.3%
Volatility	.42	.40	.36
Dividend yield	.2%	.1%	.2%

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 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 1998, 1997 and 1996 was \$17.91, \$17.67 and \$8.17 per share, respectively. The weighted average estimated fair value of shares granted under the Stock Participation Plan during 1998, 1997 and 1996 was \$10.92, \$11.04 and \$4.05, 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):

	1998	1997	1996
Pro forma net income	\$ 5,755	\$ 6,735	\$ 5,046
Pro forma basic earnings per share	\$ 1.73	\$ 2.06	\$ 1.53
Pro forma diluted earnings per share	\$ 1.66	\$ 1.88	\$ 1.42

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 employer 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 \$291 million for the Qualified Plans and the Non-Qualified Plan in 1998 (\$273 million in 1997 and \$209 million in 1996). The Company expects to fund approximately \$283 million for the 1998 contribution to the Qualified Plans and to allocate approximately \$13 million for the Non-Qualified Plan, including the utilization of amounts accrued in prior years. A remaining accrual of approximately \$205 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. The Company also provides defined-benefit pension plans in certain foreign countries. The Company's funding policy for foreign defined-benefit pension plans is consistent with the local requirements in each country. These defined-benefit pension plans had no material impact on the Company's financial statements for the periods presented.

The Company provides postemployment benefits for retired employees in the U.S. Upon retirement, eligible employees are credited with a defined dollar amount based on years of service. These credits can be used to pay all or a portion of the cost to purchase coverage in an Intel-sponsored medical plan. These benefits had no material impact on the Company's financial statements for the periods presented.

Acquisitions

In May 1998, the Company purchased the semiconductor operations of Digital Equipment Corporation, including manufacturing facilities in Massachusetts as well as development operations in Israel and Texas. The original cash purchase price of \$625 million was adjusted to \$585 million as a result of revisions to the valuations of certain capital assets as contemplated in the original purchase agreement. The purchase price remains subject to adjustment for asset valuation in accordance with the agreement. Assets acquired consisted primarily of property, plant and equipment. Following the completion of the purchase, lawsuits between the companies that had been pending since 1997 were dismissed with prejudice.

In January 1998, the Company acquired the outstanding shares of Chips and Technologies, Inc., a supplier of graphics accelerator chips for mobile computing products. The purchase price was approximately \$430 million (\$321 million in net cash). The Company recorded a non-deductible charge of \$165 million for purchased in-process research and development, representing the appraised value of products still in the development stage that were not considered to have reached technological feasibility.

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 \$64 million in 1998, \$69 million in 1997 and \$57 million in 1996. Minimum rental commitments under all non-cancelable leases with an initial term in excess of one year are payable as follows: 1999—\$35 million; 2000—\$28 million; 2001—\$22 million; 2002—\$20 million; 2003—\$15 million; 2004 and beyond—\$22 million. Commitments for construction or purchase of property, plant and equipment approximated \$2.1 billion at December 26, 1998. In connection with certain manufacturing arrangements, Intel had minimum purchase commitments of approximately \$83 million at December 26, 1998 for flash memory.

In October 1998, Intel announced that it had entered into a definitive agreement to acquire Shiva Corporation ("Shiva"), whose products include remote access and virtual private networking solutions for the small to medium enterprise market segment and the remote access needs of campuses and branch offices. Intel expects that the total cash required to complete the transaction will be approximately \$185 million, before consideration of any cash to be acquired.

Contingencies

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. The suit initially alleged that Intel infringes three Intergraph microprocessor-related patents and has been amended to add two other patents. The suit also includes alleged violations of antitrust laws and various state law claims. The suit seeks injunctive relief and unspecified damages. Intel has counterclaimed that the Intergraph patents are invalid and alleges infringement of seven Intel patents, breach of contract and misappropriation of trade secrets. In April 1998, the Court ordered Intel to continue to deal with Intergraph on the same terms as it treats allegedly similarly situated customers with respect to confidential information and product supply. Intel's appeal of this order was heard in December 1998. In June 1998, Intel filed a motion for summary judgment on Intergraph's patent claims on the grounds that Intel is licensed to use those patents. In July 1998, the Company received a letter stating that Intergraph believes that the patent damages will be "several billion dollars by the time of trial." In addition, Intergraph alleges that Intel's infringement is willful and that any damages awarded should be trebled. The letter also stated that Intergraph believes that antitrust, unfair competition and tort and contract damages will be "hundreds of millions of dollars by the time of trial." The Company disputes Intergraph's claims and intends to defend the lawsuit vigorously.

The Company is currently party to various legal proceedings, including that noted above. While management, including internal counsel, currently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not have a material adverse effect on the Company's financial position or overall trends in results of operations, litigation is subject to inherent uncertainties. Were an unfavorable ruling to occur, there exists the possibility of a material adverse impact on the net income of the period in which the ruling occurs.

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 would 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 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.

Operating segment and geographic information

Intel adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," in 1998. SFAS No. 131 establishes standards for reporting information about operating segments and related disclosures about products, geographic information and major customers. Operating segment information for 1997 and 1996 is also presented in accordance with SFAS No. 131.

Intel designs, develops, manufactures and markets microcomputer components and related products at various levels of integration. The Company is organized into four product line operating segments: Intel Architecture Business Group, Computing Enhancement Group, Network Communications Group and New Business Group. Each of these groups has a vice president who reports directly to the Chief Executive Officer ("CEO"). The CEO allocates resources to each of these groups using information on their revenues and operating profits before interest and taxes. The CEO has been identified as the Chief Operating Decision Maker as defined by SFAS No. 131.

The Intel Architecture Business Group's products include the Pentium® family of microprocessors, and microprocessors and related board-level products based on the P6 microarchitecture (including the Pentium® II processor, the Intel® Celeron™ processor and the Pentium® II Xeon™ processor). Sales of microprocessors and related board-level products based on the P6 microarchitecture represented a majority of the Company's 1998 revenues and a substantial majority of its 1998 gross margin. The Computing Enhancement Group's

Notes to consolidated financial statements

products include chipsets, embedded processors (including embedded Pentium® processors), microcontrollers, flash memory products and graphics products. The Network Communications Group's products include fast Ethernet connections, hubs, switches and routers. The New Business Group's products include systems management software, digital imaging products, and video and data conferencing products. Intel's products in all operating groups are sold directly to original equipment manufacturers, retail and industrial distributors, and resellers throughout the world.

In addition to the aforementioned operating segments, the sales and marketing, manufacturing, finance and administration groups also report to the CEO. Expenses of these groups are allocated to the operating segments and are included in the operating results reported below. Certain corporate-level operating expenses (primarily profit-dependent bonus expenses) and reserves for deferred income on shipments to distributors are not allocated to operating segments and are included in "all other" in the reconciliation of operating profits reported below.

Although the Company has four operating segments, only the Intel Architecture Business Group and Computing Enhancement Group are reportable segments under the criteria of SFAS No. 131. Intel does not identify or allocate assets or depreciation by operating segment, nor does the CEO evaluate groups on these criteria. Operating segments do not sell products to each other, and accordingly, there are no intersegment revenues to be reported. Intel does not allocate interest and other income, interest expense or taxes to operating segments. The accounting policies for segment reporting are the same as for the Company as a whole (see "Accounting policies").

Information on reportable segments for the three years ended December 26, 1998 is as follows:

(In millions)	1998	1997	1996
Intel Architecture Business Group			
Revenues	\$21,545	\$20,782	\$17,000
Operating profit	\$ 9,077	\$10,659	\$ 7,666
Computing Enhancement Group			
Revenues	\$ 4,047	\$ 3,793	\$ 3,622
Operating profit	\$ 358	\$ 529	\$ 940
All other			
Revenues	\$ 681	\$ 495	\$ 225
Operating (loss)	\$ (1,056)	\$ (1,301)	\$ (1,053)
Total			
Revenues	\$26,273	\$25,070	\$20,847
Operating profit	\$ 8,379	\$ 9,887	\$ 7,553

In 1998, one customer accounted for 13% of the Company's revenues and another customer accounted for 11%. In 1997, one customer accounted for 12% of the Company's revenues. In 1996, no customer exceeded 10% of the Company's revenues. A substantial majority of the sales to these customers were Intel Architecture Business Group products, but these customers also purchased Computing Enhancement Group products.

Enterprise-wide information is provided in accordance with SFAS No. 131. Geographic revenue information for the three years ended December 26, 1998 is based on the location of the selling entity. Property, plant and equipment information is based on the physical location of the assets at the end of each of the fiscal years.

Revenues from unaffiliated customers by geographic region were as follows:

(In millions)	1998	1997	1996
United States	\$ 11,663	\$11,053	\$ 8,668
Europe	7,452	6,774	5,876
Asia-Pacific	5,309	4,754	3,844
Japan	1,849	2,489	2,459
Total revenues	\$26,273	\$25,070	\$20,847

Net property, plant and equipment by country was as follows:

(In millions)	1998	1997
United States	\$ 8,076	\$ 8,022
Ireland	1,287	919
Other foreign countries	2,246	1,725
Total property, plant and equipment, net	\$ 11,609	\$10,666

Supplemental information (unaudited)

Quarterly information for the two years ended December 26, 1998 is presented on page 37.

The Board of Directors and Stockholders, Intel Corporation

We have audited the accompanying consolidated balance sheets of Intel Corporation as of December 26, 1998 and December 27, 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 26, 1998. 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 26, 1998 and December 27, 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 26, 1998, in conformity with generally accepted accounting principles.



San Jose, California
January 11, 1999

Management's discussion and analysis

of financial condition and results of operations

Results of operations

Intel posted record net revenues in 1998, for the 12th consecutive year, increasing by 5% from 1997, and by 20% from 1996 to 1997. The increases in both periods were primarily due to higher revenues from sales of microprocessors by the Intel Architecture Business Group and to a lesser extent due to increases in revenues of the Computing Enhancement Group.

Cost of sales increased by 22% from 1997 to 1998, primarily due to microprocessor unit volume growth and additional costs associated with purchased components for the Single Edge Contact ("SEC") cartridge housing the Pentium® II processor. From 1996 to 1997, cost of sales increased by 8.5% primarily due to microprocessor unit volume growth, costs related to the 0.25-micron microprocessor manufacturing process ramp and shifts in product mix, partially offset by factory efficiencies due to the increased volumes. The gross margin percentage was 54% in 1998, compared to 60% in 1997 and 56% in 1996. See "Outlook" for a discussion of gross margin expectations.

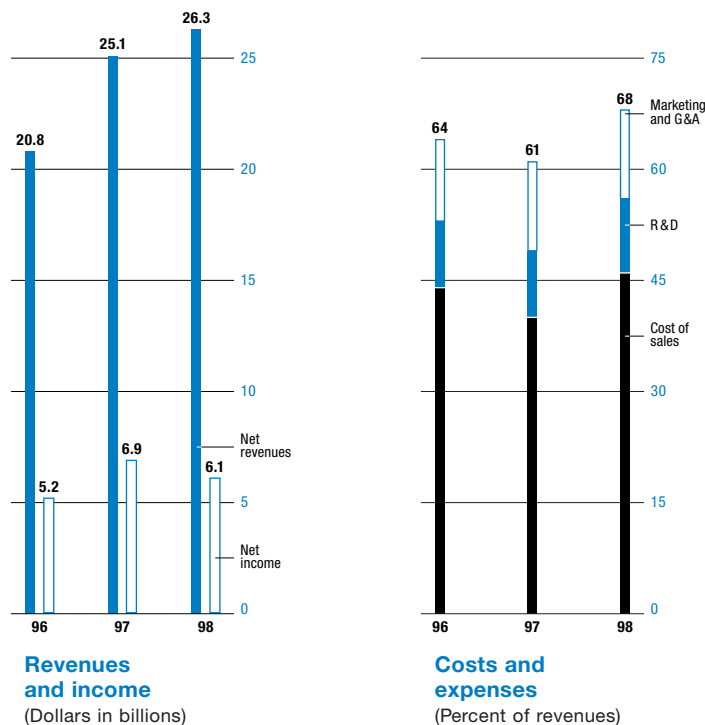
Research and development spending grew by 14% from 1997 to 1998, primarily due to increased spending on development of microprocessor products and the charge for in-process research and development related to the acquisition of Chips and Technologies, Inc. (See the discussion about purchased in-process research and development under "Computing Enhancement Group segment.") Research and development spending increased 30% from 1996 to 1997 due to substantially increased investment in both microprocessor product development and manufacturing technology development.

Marketing, general and administrative spending grew 6% in 1998, primarily due to the Intel Inside® cooperative advertising program and merchandising spending, partially offset by lower profit-dependent bonus expenses. From 1996 to 1997, marketing, general and administrative spending grew 25%, primarily due to merchandising spending, the Intel Inside program and higher profit-dependent expenses.

Interest expense increased \$7 million from 1997 to 1998 due to higher average borrowing balances and lower interest capitalization. Interest and other income was essentially unchanged for the same period, with higher gains on sales of equity securities and higher interest income offset by lower foreign currency gains. For 1997 compared to 1996, interest expense was essentially unchanged, and interest and other income increased by \$393 million, primarily due to higher average investment balances and higher gains on sales of equity investments.

The Company's effective income tax rate decreased to 33.6% in 1998 from 34.8% in 1997 and 35.0% in 1996. Foreign income taxed at rates different from U.S. rates contributed to the lower tax rate in 1998.

Intel Architecture Business Group segment. Revenues increased 4% from 1997 to 1998, primarily due to higher volumes of microprocessors sold, particularly processors based on the P6 microarchitecture (including the Intel® Celeron™



Pentium II, Pentium® Pro and Pentium® II Xeon™ processors). The higher volumes were partially offset by lower average selling prices. Revenues for this operating segment increased 22% from 1996 to 1997, primarily due to higher volumes of the Pentium® microprocessor family (including processors with Intel's MMX™ media enhancement technology) and Pentium Pro processor, and the introduction of the Pentium II processor, along with increased average selling prices in the first half of 1997 compared to the first half of 1996.

During 1998, sales of microprocessors and related board-level products based on the P6 microarchitecture comprised a majority of the Company's consolidated revenues and a substantial majority of its gross margin. Sales of these microprocessors first became a significant portion of the Company's revenues and gross margin in 1997. Also during 1998, sales of Pentium family processors, including Pentium processors with MMX technology, were a rapidly declining but still significant portion of the Company's revenues and gross margin. During 1997, sales of the Pentium family processors were a majority of the Company's revenues and gross margin, and in 1996 were a majority of its revenues and a substantial majority of its gross margin.

Operating profit for the Intel Architecture Business Group operating segment decreased 15% from 1997 to 1998, primarily due to the increased costs related to the SEC cartridge in the Pentium II processor and the lower average selling prices of processors in the first half of 1998 compared to the first half of 1997. In the second half of 1998, gross margin improved compared to the first half of the year as the transition to the P6 microarchitecture was largely complete and the SEC cartridge had no further

Management's discussion and analysis

of financial condition and results of operations

31

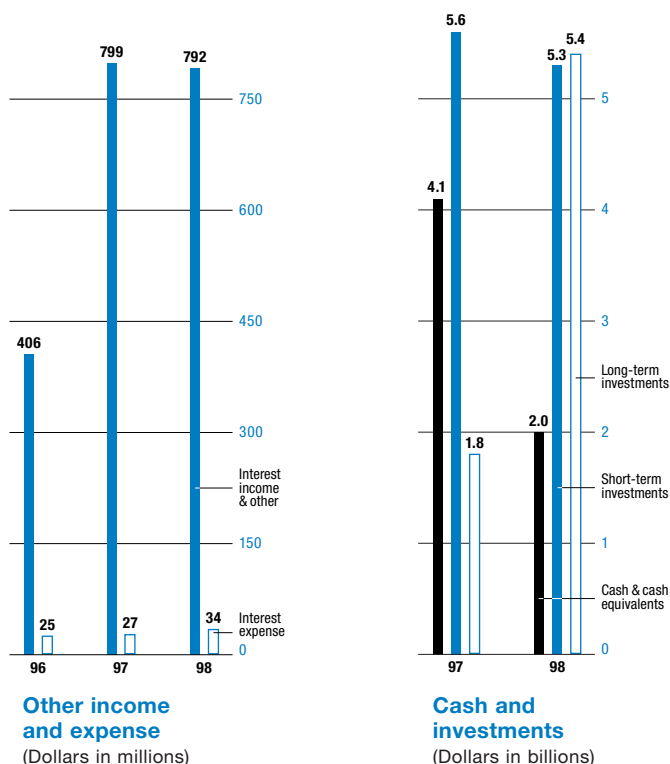
incremental impact on the gross margin percentage. In addition, in the second half of 1998, this operating segment began to see the benefit of the Company's cost reduction efforts. Operating profit for the segment increased 39% from 1996 to 1997 due to the increase in processor unit volumes and higher average selling prices in the first half of 1997 arising from the ramp of the Pentium processor with MMX technology.

Computing Enhancement Group segment. Revenues increased 7% from 1997 to 1998 and 5% from 1996 to 1997. Revenues from sales of chipsets represented a majority of revenues for this operating segment only in 1998. Chipset revenues increased primarily due to higher average selling prices in 1998 compared to 1997, and primarily due to increased unit volumes from 1996 to 1997. These increases were partially offset in both periods by decreases in revenues from sales of flash memory and embedded processors.

Operating profits for the Computing Enhancement Group operating segment declined 32% from 1997 to 1998 and 44% from 1996 to 1997, primarily due to competitive pressures in flash memory products, partially offset by increased profitability of chipsets. In 1998, the results were also negatively affected by the purchase of Chips and Technologies, Inc. ("C&T"), including the related \$165 million charge for purchased in-process research and development.

In the first quarter of 1998, the Company purchased C&T for a total price of approximately \$430 million. C&T had a product line of mobile graphics controllers based on 2D and video graphics technologies, and their major development activities included new technologies for embedded memory and 3D graphics. Other development projects included improvements to the existing 2D and video technologies, and several other new business product lines, all of which were individually insignificant.

Intel obtained an outside valuation of C&T, and values were assigned to developed technology, in-process research and development, customer base and assembled workforce. The valuations of developed technology and in-process research and development were established using an income-based approach. Revenue estimates for each product line under development were based on discussions with management, existing product family revenues, anticipated product development schedules, product sales cycles and estimated life of each of the technologies. Revenue estimates were then compared for reasonableness to external industry sources on expected market growth. Percentages of product revenues for each project were designated as developed, in-process and future yet-to-be-defined. Revenues on the products under development were estimated to begin in 1998 and continue through 2006, with the majority of the revenues related to in-process technology occurring between 2001 and 2003. Operating expenses, including cost of goods sold, were estimated based primarily on C&T's historical experience. The resulting operating income was adjusted for a charge for the use of contributory assets and income tax expense using Intel's tax rate. The risk-adjusted discount rate applied to after-



INTEL CORPORATION 1998

tax cash flow was 15% for developed technology and 20% for in-process technology, compared to an estimated weighted-average cost of capital for C&T of approximately 10%.

The total value of in-process research and development was estimated to be approximately \$165 million. Costs to complete all of the in-process projects were estimated to be \$30 million. Approximately 70% of the estimated in-process research and development was attributable to the embedded memory technology and the 3D technology that were expected to be used together and separately in products under development. Development of the first in a series of mobile graphics products using the embedded memory technology was estimated to be approximately 80% complete and was completed in August 1998. The 3D technology was at an earlier stage of development with a minimal amount of work completed at the time of the acquisition. Close to the time of the acquisition, Intel also began working with another company to license their 3D technology for a line of desktop graphics controllers. Subsequent to the acquisition, a decision was made that the mobile and desktop product lines should have compatible 3D technology, and further development of the C&T 3D technology was stopped.

Financial condition

The Company's financial condition remains very strong. At December 26, 1998, total cash, trading assets, and short- and long-term investments totaled \$13 billion, up from \$11.8 billion at December 27, 1997. Cash provided by operating activities was \$9.2 billion in 1998, compared to \$10 billion and \$8.7 billion in 1997 and 1996, respectively.

The Company used \$6.5 billion in cash for investing activities during 1998, compared to \$6.9 billion during 1997

Management's discussion and analysis

of financial condition and results of operations

and \$5.3 billion during 1996. Capital expenditures totaled \$3.6 billion in 1998, as the Company continued to invest in property, plant and equipment, primarily for additional microprocessor manufacturing capacity and the transition of manufacturing technology. The Company also purchased the semiconductor manufacturing operations of Digital Equipment Corporation for \$585 million, including \$475 million in capital assets. The Company had committed approximately \$2.1 billion for the purchase or construction of property, plant and equipment as of December 26, 1998. See "Outlook" for a discussion of capital expenditure expectations in 1999. In addition, during 1998 the Company used \$321 million in cash to purchase C&T and \$500 million to acquire a non-voting equity interest in Micron Technology, Inc.

Inventory levels in total decreased in 1998, with a decrease in raw materials and work-in-process inventory, partially offset by an increase in finished goods inventory. The increase in accounts receivable in 1998 was mainly due to the higher level of revenues. The Company's five largest customers accounted for approximately 42% of net revenues for 1998. One customer accounted for 13% of revenues and another accounted for 11% in 1998. One customer accounted for 12% of revenues in 1997 and no customer accounted for more than 10% of revenues in 1996. At December 26, 1998, the five largest customers accounted for approximately 39% of net accounts receivable.

The Company used \$4.7 billion for financing activities in 1998, compared to \$3.2 billion and \$773 million in 1997 and 1996, respectively. The major financing applications of cash in 1998 were for repurchase of 161.7 million shares of Common Stock, adjusted for the stock split declared in January 1999, for \$6.8 billion (including \$1.2 billion for exercised put warrants). The major financing applications of cash in 1997 and 1996 were for stock repurchases totaling \$3.4 billion and \$1.3 billion (including \$108 million for exercised put warrants), respectively, as well as for a \$300 million repayment in 1997 under a private reverse repurchase arrangement. Financing sources of cash during 1998 included \$507 million in proceeds from the sale of shares, primarily pursuant to employee stock plans (\$317 million in 1997 and \$257 million in 1996) and \$1.6 billion in proceeds from the exercise of 1998 Step-Up Warrants (\$40 million in 1997 and \$4 million in 1996). 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 1998, with the potential obligation to buy back 5 million shares of its Common Stock at an aggregate price of \$201 million. The exercise price of these warrants ranged from \$40 to \$41 per share, with an average exercise price of \$40 per share as of December 26, 1998.

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 October 1998, the Company announced that it had entered into a definitive agreement to acquire Shiva Corporation ("Shiva"). Intel expects that the total cash required to complete the transaction will be approximately \$185 million, before consideration of any cash to be acquired.

The Company believes that it has the financial resources needed to meet business requirements in the foreseeable future, including the acquisition of Shiva, capital expenditures for the expansion or upgrading 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. All of the potential changes noted below are based on sensitivity analyses performed on the Company's financial positions at December 26, 1998 and December 27, 1997. Actual results may differ materially.

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 substantial majority of the Company's marketable investments in long-term fixed rate debt and certain equity securities, excluding equity investments entered into for strategic purposes, are swapped to U.S. dollar LIBOR-based returns. A hypothetical 60 basis point increase in interest rates would result in an approximate \$30 million decrease (less than 0.3%) in the fair value of the Company's available-for-sale securities as of the end of 1998 (\$18 million as of the end of 1997).

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 foreign 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. For example, an adverse change in exchange rates (defined as 20% in certain Asian currencies and 10% in all other currencies) would result in an

adverse impact on income before taxes of less than \$20 million as of the end of each of 1998 and 1997.

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 companies in the high-technology industry sector, many of which are small capitalization stocks. 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 \$350 million decrease in the fair value of the Company's available-for-sale securities as of the end of 1998 (\$75 million as of the end of 1997). The increase compared to 1997 reflects the increase in the dollar value of the Company's marketable strategic equity securities, a significant portion of which represents unrealized market appreciation. Approximately \$825 million of the value of these equity securities as of the end of 1998 consisted of the investment in Micron Technology, Inc., described above under "Financial condition."

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 mergers or acquisitions that had not closed as of the end of 1998.

Intel expects that the total number of computers using Intel's Pentium family processors, P6 microarchitecture processors (including Intel Celeron, Pentium II, Pentium® III, Pentium II Xeon and Pentium® III Xeon™ processors) and other semiconductor components sold worldwide will continue to grow in 1999. The Company's financial results are substantially dependent on sales of these microprocessors by the Intel Architecture Business Group and other semiconductor components sold by the Computing Enhancement Group. Revenues are also a function of the mix of microprocessor types and speeds sold as well as the mix of related motherboards, purchased components and other semiconductor products, 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 dependent in part on the growth in usage of the Internet and the expansion of Internet product offerings. The expectations are also subject to the impact of economic conditions in various geographic regions, including the ongoing financial difficulties in the Asian markets and certain emerging markets in other regions.

Intel's strategy is to introduce ever higher performance microprocessors tailored for the different segments of the worldwide computing market, using a tiered branding approach. In line with this strategy, the Company is seeking to develop higher performance microprocessors specifically for each computing segment: the Intel Celeron processor for entry-level PC buyers interested in a value PC, the Pentium II and

Pentium III processors for the performance desktop and entry-level servers and workstations, and the Pentium II Xeon and Pentium III Xeon processors for mid-range and high-end servers and workstations. The Company plans to cultivate new businesses and continue to work with the computing industry to expand Internet capabilities and product offerings and to develop compelling software applications that can take advantage of this higher performance, thus driving demand toward the newer products in each computing market segment. The Company may continue to take various steps, including reducing microprocessor prices at such times as it deems appropriate, in order to increase acceptance of its latest technology and to remain competitive 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 motherboards and purchased components within a product family. The Company's Pentium II processor is packaged with purchased components in the SEC cartridge, and the inclusion of purchased components has tended to increase absolute margin dollars but to lower the gross margin percentage. However, the Company has also been developing new packaging formats that use fewer purchased components. These new packaging formats are expected to reduce costs on certain microprocessor products. In addition, the Company expects to have reduced costs due to continued productivity improvements on its existing manufacturing processes during 1999. Various other factors—including unit volumes, yield issues associated with production at factories, ramp of new technologies, excess or obsolete inventory, variations in inventory valuation 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 in future quarters.

Intel's current gross margin expectation for 1999 is 57% plus or minus a few points compared to 54% for 1998. Intel's primary goal is to get its advanced technology to the marketplace, and the Company sometimes may implement strategies that increase margin dollars but lower margin percentages, for example, the Company's plans to grow in non-microprocessor areas that have the potential to expand computing and communications capabilities. 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 semiconductor manufacturing and assembly and test capacity over the last few years, and continues to plan capacity based on the assumed continued success of its strategy and the acceptance of its products in specific market segments. The Company expects that capital spending will decrease to approximately \$3 billion in 1999, primarily as a result of reduced investment for new facilities and improved utilization of equipment. 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

Management's discussion and analysis

of financial condition and results of operations

capacity installed might 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. This spending plan is dependent upon expectations regarding production efficiencies and delivery times of various machinery and equipment. Depreciation and amortization for 1999 is expected to be approximately \$3.4 billion, an increase of approximately \$600 million from 1998. Most of this increase 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. Since Intel considers it imperative to maintain a strong research and development program, spending for research and development in 1999 is expected to increase to approximately \$3 billion. The Company intends to 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 1999.

The Company currently expects its tax rate to be 33.5% for 1999. This estimate is based on current tax law and the current estimate of earnings, and is subject to change.

Intel has established a team to address the issues raised by the introduction of the Single European Currency ("Euro") on January 1, 1999 and during the transition period through January 1, 2002. Intel's internal systems that are affected by the initial introduction of the Euro have been made Euro capable without material system modification costs. Further internal systems changes will be made during the three-year transition phase in preparation for the ultimate withdrawal of the legacy currencies in July 2002, and the costs of these changes are not expected to be material. The Company does not presently expect that introduction and use of the Euro will materially affect the Company's foreign exchange and hedging activities, or the Company's use of derivative instruments, or will result in any material increase in costs to the Company. While Intel will continue to evaluate the impact of the Euro introduction over time, based on currently available information, management does not believe that the introduction of the Euro will have a material adverse impact on the Company's financial condition or overall trends in results of operations.

Like many other companies, Intel is subject to risks from the year 2000 computer issue. If internal systems do not correctly recognize and process date information beyond the year 1999, there could be an adverse impact on the Company's operations. Two other related issues could also lead to incorrect calculations or failures: i) some systems' programming assigns special meaning to certain dates, such as 9/9/99 and ii) the fact that the year 2000 is a leap year.

The Company has established a comprehensive program with dedicated program management and executive-level sponsorship to deal with year 2000 issues. The Company

is addressing its most critical internal systems first and has categorized as "critical" or "priority" those systems whose failure would cause an extended shutdown of all or part of a factory, could cause personal injury or would have a sustained and significant detrimental financial impact. The Company is also testing customer and supplier interfaces with its internal systems as appropriate. These activities are intended to encompass all major categories of systems in use by the Company, including network and communications infrastructure, manufacturing, facilities management, sales, finance and human resources. The Company's approach prioritizes functions and systems worldwide, and all divisions and facilities are working toward the same global milestones.

The Company's semiconductor manufacturing and assembly and test ("manufacturing") equipment and systems are highly automated, incorporating PCs, embedded processors and related software to control scheduling, inventory tracking, statistical analysis and automated manufacturing. A significant portion of the Company's year 2000 efforts on internal systems is intended to prevent disruption to manufacturing operations.

As of December 1998, approximately 99% of the Company's critical and priority manufacturing systems, and 85% of critical and priority non-manufacturing systems, were determined to be already year 2000 capable, or remediation needed (replacements, changes, upgrades or workarounds) has been determined and unit testing completed. Deployment of replacements, changes and upgrades has been completed for 93% of manufacturing systems and 84% of non-manufacturing systems. The Company has planned a comprehensive program of integration testing of internal systems. The integration testing began in the third quarter of 1998 and will continue into 1999 as necessary.

The following table indicates the phases of the year 2000 project related to the Company's critical and priority internal systems and the expected time frames.

Phases of the project	Start date	End date
High-level assessment of systems	1996	Q3 1998 (actual)
Detailed assessment, remediation and unit testing	1996	Q1 1999 (expected)
Deployment	1997	Mid-1999 (expected)
Integration testing	Q3 1998	Mid-1999 (expected)

Intel is also actively working with suppliers of products and services to determine the extent to which the suppliers' operations and the products and services they provide are year 2000 capable, and to monitor their progress toward year 2000 capability. Highest priority is being placed on working with critical suppliers, defined by Intel as those whose failure would shut down manufacturing or other critical operations within a short period of time. The Company has made inquiries of its major suppliers and has received responses to its initial inquiries from 100% of critical suppliers.

Follow-up activities seek to determine whether the supplier is taking all appropriate steps to fix year 2000 problems and to be prepared to continue functioning effectively as a

supplier in accordance with Intel's standards and requirements. Contingency plans are being developed to address issues related to suppliers that are not considered to be making sufficient progress in becoming year 2000 capable.

The Company is also developing contingency plans to address possible changes in customer order patterns due to year 2000 issues. As with suppliers, the readiness of customers to deal with year 2000 issues may affect their operations and their ability to order and pay for products. Intel has surveyed its major direct customers about their year 2000 readiness in critical areas of their operations. The results identified certain key areas to be addressed by the customers. Intel is also communicating information about its own readiness to customers and is conducting seminars to help communicate the methodologies and processes used in Intel's year 2000 programs.

Intel believes that its most reasonably likely worst-case year 2000 scenarios would relate to problems with the systems of third parties rather than with the Company's internal systems or its products. Because the Company has less control over assessing and remediating the year 2000 problems of third parties, the Company believes the risks are greatest with infrastructure (e.g., electricity supply and water and sewer service), telecommunications, transportation supply chains and critical suppliers of materials.

The Company's microprocessor production is conducted in a network of domestic and foreign facilities. Each location relies on local private and governmental suppliers for electricity, water, sewer and other needed supplies. Failure of an electricity grid or an uneven supply of power, for example, would be a worst-case scenario that would completely shut down the affected facilities. Electrical failure could also shut down airports and other transportation facilities.

The Company does not generally maintain facilities that would allow it to generate its own electrical or water supply in lieu of that supplied by utilities. To the extent possible, the Company is working with the infrastructure suppliers for its manufacturing sites, major subcontractor sites and relevant transportation hubs to seek to better ensure continuity of infrastructure services. Contingency planning regarding major infrastructure failure generally emphasizes planned increases in inventory levels of specific products and the shift of production to unaffected sites. By the end of 1999, Intel expects to have in place a buffer supply of finished goods inventory and is evaluating where to locate inventory geographically in light of infrastructure concerns. In addition, multiple plants engage in similar tasks in the Intel system, and production can be expanded at some sites to partially make up for capacity unavailable elsewhere. Although overall capacity would be reduced, it is not expected that the entire production system would halt due to the unavailability of one or two facilities.

A worst-case scenario involving a critical supplier of materials would be the partial or complete shutdown of the supplier and its resulting inability to provide critical supplies to the Company on a timely basis. The Company does not maintain

the capability to replace most third-party supplies with internal production. Where efforts to work with critical suppliers to ensure year 2000 capability have not been successful, contingency planning generally emphasizes the identification of substitute and second-source suppliers, and in certain situations includes a planned increase in the level of inventory carried. In an industry characterized by rapid technological change, higher levels of raw materials and finished goods inventories involve increased risk of inventory obsolescence and the potential for write-downs in the value of inventory.

The Company is not in a position to identify or to avoid all possible scenarios; however, the Company is currently assessing scenarios and taking steps to mitigate the impacts of various scenarios if they were to occur. This contingency planning will continue through 1999 as the Company learns more about the preparations and vulnerabilities of third parties regarding year 2000 issues. Due to the large number of variables involved, the Company cannot provide an estimate of the damage it might suffer if any of these scenarios were to occur.

The Company also has a program to assess the capability of its products to handle the year 2000. To assist customers in evaluating their year 2000 issues, the Company has developed a list that indicates the capability of Intel's current products, and certain products no longer being produced, to handle the year 2000. Products are assigned to one of five categories as defined by the Company: "Year 2000 Capable," "Year 2000 Capable" with update, not "Year 2000 Capable," under evaluation and will not test. The list is located on the Company's Year 2000 support Web site and is periodically updated as analysis on additional products is completed.

All Intel processors are "Year 2000 Capable." All Intel microcontrollers (embedded processors) are also "Year 2000 Capable," with the exception of two custom microcontroller products sold to a limited number of customers. However, the assessment of whether a complete system will operate correctly depends on firmware (BIOS) capability and software design and integration, and for many end users this will include firmware and software provided by companies other than Intel.

As described more fully at the support Web site, Intel offers a "Year 2000 Capable" Limited Warranty on certain of its current products. Except as specifically provided for in the Limited Warranty, the Company does not believe it is legally responsible for costs incurred by customers related to ensuring their year 2000 capability. Nevertheless, the Company is incurring various costs to provide customer support and customer satisfaction services regarding year 2000 issues, and it is anticipated that these expenditures will continue through 1999 and thereafter. An Intel product, when used in accordance with its associated documentation, is "Year 2000 Capable" when, upon installation, it accurately stores, displays, processes, provides and/or receives data from, into and between 1999 and 2000, and the 20th and 21st centuries, including leap-year calculations, provided

Management's discussion and analysis

of financial condition and results of operations

that all other technology used in combination with the Intel product properly exchanges date data with it.

Various of the Company's disclosures and announcements concerning its products and year 2000 programs are intended to constitute "Year 2000 Readiness Disclosures" as defined in the recently enacted Year 2000 Information and Readiness Disclosure Act. The Act provides added protection from liability for certain public and private statements concerning an entity's year 2000 readiness and the year 2000 readiness of its products and services. The Act also potentially provides added protection from liability for certain types of year 2000 disclosures made after January 1, 1996 and before the date of enactment of the Act.

The Company's year 2000 efforts have been undertaken largely with its existing personnel. In some instances, consultants have been engaged to provide specific assessment, remediation or other services. Activities with suppliers and customers have also involved their staffs and consultants. The Company engaged a third-party firm to assist with planning and taking the inventory of internal systems, and engaged another firm to perform an assessment of the overall scope and schedule of Intel's year 2000 efforts.

The Company currently expects that the total cost of these programs, including both incremental spending and redeployed resources, will not exceed \$175 million. This estimate is lower than the previous estimate that costs would not exceed \$250 million, primarily due to a higher than expected percentage of manufacturing systems requiring no remediation and lower than expected costs of remediation on the remaining manufacturing systems. Approximately \$42 million has been spent on the programs to date, of which approximately \$36 million was incurred in 1998. Costs include estimated payroll costs for redeployed personnel and the costs of consultants, software and hardware upgrades, and dedicated program offices. A majority of the total estimated costs are expected to be incurred in assessing and remediating issues with manufacturing systems and contingency planning for manufacturing systems. As a result, a majority of the costs are expected to be included in cost of sales and in the calculation of gross margin. Year 2000 costs for manufacturing and non-manufacturing internal systems in 1998 represented less than 10% of the total information technology budget for 1998 and are also expected to be less than 10% of the budget for 1999.

No significant internal systems projects are being deferred due to the year 2000 program efforts. In some instances, the installation schedule of new software and hardware in the normal course of business is being accelerated to also afford a solution to year 2000 capability issues. The Company expects that costs related to accelerated systems replacements will be approximately \$15 million in addition to the total costs noted above. In addition, the estimated costs do not include any potential costs related to customer or other claims, or potential amounts related to executing contingency plans, such as costs incurred as a result of an infrastructure or supplier failure. The Company has adequate

general corporate funds with which to pay for the programs' expected costs. All expected costs are based on the current assessment of the programs and are subject to change as the programs progress.

Based on currently available information, management does not believe that the year 2000 matters discussed above related to internal systems or products sold to customers will have a material adverse impact on the Company's financial condition or overall trends in results of operations; however, it is uncertain to what extent the Company may be affected by such matters. In addition, there can be no assurance that the failure to ensure year 2000 capability by a supplier, customer or another third party would not have a material adverse effect on the Company's financial condition or overall trends in results of operations.

In September 1997, the Federal Trade Commission ("FTC") staff notified Intel that the FTC had begun an investigation of the Company's business practices. In June 1998, the FTC filed an administrative complaint against Intel before an FTC Administrative Law Judge. The complaint charges that Intel is attempting to further its alleged microprocessor monopoly by improperly withholding its intellectual property, in the form of confidential product information, from three companies that had filed or threatened to file intellectual property lawsuits against Intel. Although the outcome of the administrative action cannot 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 trends in results of operations.

The Company is currently party to various legal proceedings. Although litigation is subject to inherent uncertainties, management, including internal counsel, does not believe that the ultimate outcome of these legal proceedings will have a material adverse effect on the Company's financial position or overall trends in results of operations. However, were an unfavorable ruling to occur in any specific period, there exists the possibility of a material adverse impact on the results of operations of that period. Management believes, given the Company's current liquidity and cash and investments balances, that even an adverse judgment would not have a material impact on cash and investments or liquidity.

The Company's future results of operations and the other forward-looking statements contained in this outlook—in particular the statements regarding the number of computers using Intel processors, costs, gross margin, capital spending, depreciation and amortization, research and development, marketing and general and administrative expenses, the tax rate, the conversion to the Euro, the year 2000 issue, the FTC investigation and pending legal proceedings—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 end user demand due to usage of the Internet; changes in customer order patterns, including changes in customer and channel inventory levels and changes due to year 2000

systems or systems of suppliers, infrastructure providers and other third parties adversely affected by year 2000 problems; claims due to year 2000 issues allegedly related to the Company's products or year 2000 remediation efforts; and litigation involving anti-trust, 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.

(In millions—except per share amounts)
1998 for quarter ended

(In millions—except per share amounts)
1997 for quarter ended

^(c)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 traded on The Nasdaq Stock Market prior to their March 1998 expiration. Intel's Common Stock also trades on The Swiss Exchange. At December 26, 1998, there were approximately 203,000 registered holders of Common Stock. All stock and warrant prices are closing prices per The Nasdaq Stock Market, as adjusted for stock splits.

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www.intc.com—Intel's Investor Relations home page on the World Wide Web contains background on the Company and its products, financial information, job listings, frequently asked questions and our animated online annual report, as well as other useful information.

For investor information, including additional annual reports, 10-Ks, 10-Qs or any other financial literature, please see our Web site at www.intc.com or contact Harris Trust & Savings Bank at (800) 298-0146 (U.S. and Canada) or (312) 360-5123 (worldwide); or call Intel at (44) 1793 403 000 (Europe); (852) 3955 4555 (Hong Kong); (81) 298 47 8511 (Japan).

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Intel's Dividend Reinvestment Program allows stockholders to reinvest dividends and contribute additional cash to purchase Intel Common Stock on an occasional or monthly basis. For more information, call Intel's transfer agent, Harris Trust & Savings Bank, at (800) 298-0146 (U.S. and Canada) or (312) 360-5123 (worldwide).

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Independent auditors

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Intel employees dramatically reduced workplace injuries and illnesses again in 1998. Over the past four years, the Company has reduced the OSHA-recordable injury rate an average of 37% each year and the lost-day case rate an average of 30% each year. The American Association of Occupational Health Nurses honored Intel with its highest Business Recognition Award for our promotion of a safe and healthy work environment, and support of occupational health nursing programs.

Through our Design for the Environment processes, we have achieved water and energy use reductions per manufacturing unit on each of our last four generations of semiconductor manufacturing. We developed a new corporate policy and improvements to our process for ensuring that our suppliers adhere to our high environmental, health and safety ("EHS") expectations, and we exceeded our goal of recycling more than 55% of solid and chemical wastes in 1998. The worldwide EHS organization was awarded the Intel Quality Award, which since 1991 has recognized Intel organizations that have excellent performance.

Please see our Environmental, Health and Safety Performance Report at www.intel.com/intel/other/ehs/index.htm. For a printed copy, call (800) 316-5542 (U.S. and Canada) or (480) 552-2771 (worldwide).

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To learn more about Intel Corporation, visit our site on the World Wide Web at www.intel.com

About Intel

1998 marked Intel's 30th anniversary. The Company was founded in 1968 to build semiconductor memory products. It has been more than 25 years since Intel introduced the world's first microprocessor, making technological history. The computer and Internet 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 connected computing industry worldwide.

Principal products

Intel architecture platform 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. Intel offers microprocessors optimized for each segment of the computing market:

- ⇒ The Pentium® II Xeon™ processor for mid- to high-end servers and workstations
- ⇒ The Pentium® II processor for entry-level servers and workstations and performance desktop PCs
- ⇒ The Intel® Celeron™ processor for value PC desktop systems
- ⇒ The mobile Pentium II processor for performance in mobile PC systems

Motherboards combine Intel microprocessors and chipsets to form the basic subsystem of a PC or server.

Computing 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.

Network communications products

These products enhance the capabilities of PC systems and networks, and are sold through reseller, retail and original equipment manufacturer ("OEM") channels.

Major customers

Intel's major customers include:

- ⇒ **Original equipment manufacturers** of computer systems and peripherals.
- ⇒ **PC users**—including individuals, large and small businesses, and Internet service providers—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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