

INTEL CORP
Form 10-K/A
February 24, 2004
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A AMENDMENT NO. 1

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 27, 2003.

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____.

Commission File Number 0-06217

INTEL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

2200 Mission College Boulevard, Santa Clara, California

94-1672743

(I.R.S. Employer
Identification No.)

95052-8119

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code **(408) 765-8080**

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common stock, \$0.001 par value

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

Aggregate market value of voting stock held

by non-affiliates of the registrant as of June 27, 2003

\$129.2 billion

6,484 million shares of common stock outstanding as of January 30, 2004

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the registrant's Proxy Statement relating to its 2004 Annual Stockholders Meeting, to be filed subsequently Part III.

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INTEL CORPORATION

FORM 10-K/A

AMENDMENT NO. 1

FOR THE FISCAL YEAR ENDED DECEMBER 27, 2003

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EXPLANATORY NOTE

This Form 10-K/A is being filed solely to correct typographical errors in Item 8 of Intel's Annual Report on Form 10-K for the year ended December 27, 2003 filed with the Securities and Exchange Commission on February 23, 2004. Specifically, in a table in Note 12: Employee Stock Benefit Plans of the Notes to Consolidated Financial Statements, under the sub-heading SFAS No. 123 Assumptions and Fair Value, the risk-free interest rate for 2003 was 2.2% and not 12.2%. In addition, in the table Supplemental Data: Financial Information by Quarter, the revenue for the quarter ended March 29, 2003 was \$6,751 million rather than \$6,715 million.

The amendment conforms the Form 10-K as filed to the version that was certified by Intel's Chief Executive Officer and by the Chief Financial Officer and Principal Accounting Officer, pursuant to Rules 13a-14(a) and 13a-14(b) under the Securities Exchange Act of 1934, as amended (Exchange Act). No other changes are being made by means of this filing.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Three Years Ended December 27, 2003

| (In Millions Except Per Share Amounts) | 2003 | 2002 | 2001 |
|--|------------------|------------------|------------------|
| Net revenue | \$ 30,141 | \$ 26,764 | \$ 26,539 |
| Cost of sales | 13,047 | 13,446 | 13,487 |
| Gross margin | 17,094 | 13,318 | 13,052 |
| Research and development | 4,360 | 4,034 | 3,796 |
| Marketing, general and administrative | 4,278 | 4,334 | 4,464 |
| Impairment of goodwill | 617 | | 98 |
| Amortization of goodwill | | | 1,612 |
| Amortization and impairment of acquisition-related intangibles and costs | 301 | 548 | 628 |
| Purchased in-process research and development | 5 | 20 | 198 |
| Operating expenses | 9,561 | 8,936 | 10,796 |
| Operating income | 7,533 | 4,382 | 2,256 |
| Losses on equity securities, net | (283) | (372) | (466) |
| Interest and other, net | 192 | 194 | 393 |
| Income before taxes | 7,442 | 4,204 | 2,183 |
| Provision for taxes | 1,801 | 1,087 | 892 |
| Net income | \$ 5,641 | \$ 3,117 | \$ 1,291 |
| Basic earnings per common share | \$ 0.86 | \$ 0.47 | \$ 0.19 |
| Diluted earnings per common share | \$ 0.85 | \$ 0.46 | \$ 0.19 |
| Weighted average common shares outstanding | 6,527 | 6,651 | 6,716 |
| Weighted average common shares outstanding, assuming dilution | 6,621 | 6,759 | 6,879 |

See accompanying notes.

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INTEL CORPORATION
CONSOLIDATED BALANCE SHEETS

December 27, 2003 and December 28, 2002

| (In Millions Except Par Value) | 2003 | 2002 |
|--|------------------|------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 7,971 | \$ 7,404 |
| Short-term investments | 5,568 | 3,382 |
| Trading assets | 2,625 | 1,801 |
| Accounts receivable, net of allowance for doubtful accounts of \$55 (\$57 in 2002) | 2,960 | 2,574 |
| Inventories | 2,519 | 2,276 |
| Deferred tax assets | 969 | 1,136 |
| Other current assets | 270 | 352 |
| Total current assets | 22,882 | 18,925 |
| Property, plant and equipment, net | 16,661 | 17,847 |
| Marketable strategic equity securities | 514 | 56 |
| Other long-term investments | 1,866 | 1,178 |
| Goodwill | 3,705 | 4,330 |
| Other assets | 1,515 | 1,888 |
| Total assets | \$ 47,143 | \$ 44,224 |
| Liabilities and stockholders equity | | |
| Current liabilities: | | |
| Short-term debt | \$ 224 | \$ 436 |
| Accounts payable | 1,660 | 1,543 |
| Accrued compensation and benefits | 1,559 | 1,287 |
| Accrued advertising | 716 | 622 |
| Deferred income on shipments to distributors | 633 | 475 |
| Other accrued liabilities | 1,302 | 1,075 |
| Income taxes payable | 785 | 1,157 |
| Total current liabilities | 6,879 | 6,595 |
| Long-term debt | 936 | 929 |
| Deferred tax liabilities | 1,482 | 1,232 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock, \$0.001 par value, 50 shares authorized; none issued | | |
| Common stock, \$0.001 par value, 10,000 shares authorized; 6,487 issued and outstanding (6,575 in 2002) and capital in excess of par value | 6,754 | 7,641 |
| Acquisition-related unearned stock compensation | (20) | (63) |
| Accumulated other comprehensive income | 96 | 43 |
| Retained earnings | 31,016 | 27,847 |
| Total stockholders equity | 37,846 | 35,468 |

| | | |
|--|------------------|------------------|
| Total liabilities and stockholders equity | \$ 47,143 | \$ 44,224 |
|--|------------------|------------------|

See accompanying notes.

Table of Contents**INTEL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS**

Three Years Ended December 27, 2003

| (In Millions) | 2003 | 2002 | 2001 |
|---|-----------------|-----------------|-----------------|
| Cash and cash equivalents, beginning of year | \$ 7,404 | \$ 7,970 | \$ 2,976 |
| Cash flows provided by (used for) operating activities: | | | |
| Net income | 5,641 | 3,117 | 1,291 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 4,651 | 4,676 | 4,131 |
| Impairment of goodwill | 617 | | 98 |
| Amortization of goodwill | | | 1,612 |
| Amortization and impairment of intangibles and other acquisition-related costs | 419 | 668 | 717 |
| Purchased in-process research and development | 5 | 20 | 198 |
| Losses on equity securities, net | 283 | 372 | 466 |
| Loss on investment in Convera | | | 196 |
| Net loss on retirements and impairments of property, plant and equipment | 217 | 301 | 119 |
| Deferred taxes | 391 | 110 | (519) |
| Tax benefit from employee stock plans | 216 | 270 | 435 |
| Changes in assets and liabilities: | | | |
| Trading assets | (511) | (444) | 898 |
| Accounts receivable | (430) | 30 | 1,561 |
| Inventories | (245) | (26) | 24 |
| Accounts payable | 116 | (226) | (673) |
| Accrued compensation and benefits | 276 | 107 | (524) |
| Income taxes payable | (361) | 175 | (270) |
| Other assets and liabilities | 230 | (21) | (971) |
| Total adjustments | 5,874 | 6,012 | 7,498 |
| Net cash provided by operating activities | 11,515 | 9,129 | 8,789 |
| Cash flows provided by (used for) investing activities: | | | |
| Additions to property, plant and equipment | (3,656) | (4,703) | (7,309) |
| Acquisitions, net of cash acquired | (61) | (57) | (883) |
| Purchases of available-for-sale investments | (11,662) | (6,309) | (7,141) |
| Maturities and sales of available-for-sale investments | 8,488 | 5,634 | 15,398 |
| Other investing activities | (199) | (330) | (395) |
| Net cash used for investing activities | (7,090) | (5,765) | (330) |
| Cash flows provided by (used for) financing activities: | | | |
| Increase (decrease) in short-term debt, net | (152) | (101) | 23 |
| Additions to long-term debt | | 55 | 306 |
| Repayments of debt | (137) | (18) | (10) |
| Proceeds from sales of shares through employee stock benefit plans and other | 967 | 681 | 762 |
| Repurchase and retirement of common stock | (4,012) | (4,014) | (4,008) |
| Payment of dividends to stockholders | (524) | (533) | (538) |

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| | | | |
|---|-----------------|-----------------|-----------------|
| Net cash used for financing activities | (3,858) | (3,930) | (3,465) |
| Net increase (decrease) in cash and cash equivalents | 567 | (566) | 4,994 |
| Cash and cash equivalents, end of year | \$ 7,971 | \$ 7,404 | \$ 7,970 |
| Supplemental disclosures of cash flow information: | | | |
| Cash paid during the year for: | | | |
| Interest | \$ 59 | \$ 66 | \$ 53 |
| Income taxes | \$ 1,567 | \$ 475 | \$ 1,208 |

See accompanying notes.

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INTEL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

| | Common Stock and Capital in Excess of Par Value | | Acquisition- Related Unearned Stock | Accumulated Other Compre- hensive Income | Retained Earnings | Total |
|--|---|-----------------|--|--|----------------------|------------------|
| | Number of Shares | Amount | Compen- sation | | | |
| Three Years Ended December 27, 2003 | | | | | | |
| (In Millions Except Per Share Amounts) | | | | | | |
| Balance at December 30, 2000 | 6,721 | \$ 8,486 | \$ (97) | \$ 195 | \$ 28,738 | \$ 37,322 |
| Components of comprehensive income: | | | | | | |
| Net income | | | | | 1,291 | 1,291 |
| Change in net unrealized holding gain on available-for-sale investments, net of tax | | | | (163) | | (163) |
| Change in net unrealized holding loss on derivatives, net of tax | | | | (7) | | (7) |
| Total comprehensive income | | | | | | 1,121 |
| Proceeds from sales of shares through employee stock benefit plans, tax benefit of \$435 and other | 81 | 1,197 | | | | 1,197 |
| Issuance of common stock and assumption of stock options in connection with acquisitions, net | 21 | 817 | (255) | | | 562 |
| Amortization of acquisition-related unearned stock compensation | | | 174 | | | 174 |
| Repurchase and retirement of common stock | (133) | (1,667) | | | (2,341) | (4,008) |
| Cash dividends declared (\$0.08 per share) | | | | | (538) | (538) |
| Balance at December 29, 2001 | 6,690 | 8,833 | (178) | 25 | 27,150 | 35,830 |
| Components of comprehensive income: | | | | | | |
| Net income | | | | | 3,117 | 3,117 |
| Change in net unrealized holding gain on available-for-sale investments, net of tax | | | | (19) | | (19) |
| Change in net unrealized holding gain on derivatives, net of tax | | | | 43 | | 43 |
| Minimum pension liability in excess of plan assets, net of tax | | | | (6) | | (6) |
| Total comprehensive income | | | | | | 3,135 |
| Proceeds from sales of shares through employee stock benefit plans, tax benefit of \$270 and other | 68 | 951 | | | | 951 |
| Amortization of acquisition-related unearned stock compensation, net of | | (16) | 115 | | | 99 |

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adjustments

| | | | | | | |
|--|--------------|-----------------|----------------|--------------|------------------|------------------|
| Repurchase and retirement of common stock | (183) | (2,127) | | | (1,887) | (4,014) |
| Cash dividends declared (\$0.08 per share) | | | | | (533) | (533) |
| Balance at December 28, 2002 | 6,575 | 7,641 | (63) | 43 | 27,847 | 35,468 |
| Components of comprehensive income: | | | | | | |
| Net income | | | | | 5,641 | 5,641 |
| Change in net unrealized holding gain on available-for-sale investments, net of tax | | | | 22 | | 22 |
| Change in net unrealized holding gain on derivatives, net of tax | | | | 26 | | 26 |
| Minimum pension liability in excess of plan assets, net of tax | | | | 5 | | 5 |
| Total comprehensive income | | | | | | 5,694 |
| Proceeds from sales of shares through employee stock benefit plans, tax benefit of \$216 and other | | | | | | |
| | 88 | 1,183 | | | | 1,183 |
| Amortization of acquisition-related unearned stock compensation, net of adjustments | | (6) | 43 | | | 37 |
| Repurchase and retirement of common stock | (176) | (2,064) | | | (1,948) | (4,012) |
| Cash dividends declared (\$0.08 per share) | | | | | (524) | (524) |
| Balance at December 27, 2003 | 6,487 | \$ 6,754 | \$ (20) | \$ 96 | \$ 31,016 | \$ 37,846 |

See accompanying notes.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

Intel Corporation has a fiscal year that ends on the last Saturday in December. Fiscal year 2003, a 52-week year, ended on December 27, 2003. Fiscal year 2002 was a 52-week year that ended on December 28, and fiscal year 2001, also a 52-week year, ended on December 29. The next 53-week year will end on December 31, 2005.

The consolidated financial statements include the accounts of Intel and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated. Partially owned, non-controlled equity affiliates are accounted for under the equity method. Accounts denominated in non-U.S. currencies have been remeasured using the U.S. dollar as the functional currency. Certain amounts reported in previous years have been reclassified to conform to the 2003 presentation.

Note 2: Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. The accounting estimates that require management's most difficult and subjective judgments include the assessment of recoverability of property, plant, and equipment and goodwill; the valuation of non-marketable equity securities and inventory; and the recognition and measurement of income tax assets and liabilities. The actual results experienced by the company may differ from management's estimates.

Cash and Cash Equivalents

Highly liquid debt securities with insignificant interest rate risk and with original maturities from the date of purchase of three months or less are classified as cash and cash equivalents.

Investments

Trading Assets. Trading assets are stated at fair value, with gains or losses resulting from changes in fair value recognized currently in earnings. The company elects to classify as trading assets a portion of its marketable debt securities. For these debt securities, gains or losses from changes in fair value due to interest rate and currency market fluctuations, offset by losses or gains on related derivatives, are included in interest and

other, net. A portion of the company's marketable equity securities may from time to time be classified as trading assets, if the company no longer deems the investments to be strategic in nature at the time of trading asset designation, and has the ability and intent to mitigate equity market risk through sale or the use of derivative instruments. For these marketable equity securities, gains or losses from changes in fair value, primarily offset by losses or gains on related derivative instruments, are included in gains (losses) on equity securities, net. Also included in trading assets is a marketable equity portfolio held to generate returns that seek to offset changes in liabilities related to the equity market risk of certain deferred compensation arrangements. Gains or losses from changes in fair value of these equity securities, offset by losses or gains on the related liabilities, are included in interest and other, net. The company also uses fixed income investments and derivative instruments to seek to offset the remaining portion of the changes in the compensation liabilities.

Available-for-Sale Investments. Investments designated as available-for-sale include marketable debt and equity securities. Investments that are designated as available-for-sale as of the balance sheet date 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 and losses on the sale of debt securities are recorded in interest and other, net. Realized gains or losses on the sale or exchange of equity securities and declines in value judged to be other than temporary are recorded in gains (losses) on equity securities, net. Marketable equity securities are presumed to be impaired if the fair value is less than the cost basis continuously for six months, absent compelling evidence to the contrary.

Debt securities with original maturities greater than three months and remaining maturities less than one year are classified as short-term investments. Debt securities with remaining maturities greater than one year are classified as long-term investments.

The company acquires certain equity investments for the promotion of business and strategic objectives, and to the extent that these investments continue to have strategic value, the company typically does not attempt to reduce or eliminate the inherent market risks through hedging activities. The marketable portion of these investments is included in marketable strategic equity securities.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Non-Marketable Equity Securities and Other Investments. Non-marketable equity securities and other investments are accounted for at historical cost or, if Intel has significant influence over the investee, using the equity method of accounting. Intel's proportionate share of income or losses from investments accounted for under the equity method, and any gain or loss on disposal, are recorded in interest and other, net. Non-marketable equity securities, equity-method investments and other investments are included in other assets. All of the company's investments are subject to a periodic impairment review; however, for non-marketable equity securities, the impairment analysis requires significant judgment to identify events or circumstances that would likely have a significant adverse effect on the fair value of the investment. The indicators Intel uses to identify those events and circumstances include the investee's revenue and earnings trends relative to predefined milestones and overall business prospects; the technological feasibility of the investee's products and technologies; the general market conditions in the investee's industry; and the investee's liquidity, debt ratios and the rate at which the investee is using cash. Investments identified as having an indicator of impairment are subject to further analysis to determine if the investment is other than temporarily impaired, in which case the investment is written down to its impaired value. When an investee is not considered viable from a financial or technological point of view, the entire investment is written down, since the estimated fair market value is considered to be nominal. If an investee obtains additional funding at a valuation lower than Intel's carrying amount or requires a new round of equity funding to stay in operation, and the new funding does not appear imminent, it is presumed that the investment is other than temporarily impaired, unless specific facts and circumstances indicate otherwise. Impairment of non-marketable equity securities is recorded in gains (losses) on equity securities, net.

Securities Lending

From time to time, the company enters into securities lending agreements with financial institutions, generally to facilitate hedging transactions. Selected securities are loaned and are secured by collateral in the form of cash or securities. The loaned securities continue to be carried as investment assets on the balance sheet. Cash collateral is recorded as an asset with a corresponding liability. For lending agreements collateralized by securities, the collateral is not recorded as an asset or a liability, unless the collateral is repledged. See Note 5: Borrowings.

Fair Values of Financial Instruments

Fair values of cash equivalents approximate cost due to the short period of time to maturity. Fair values of short-term investments, trading assets, long-term investments, marketable strategic equity securities, certain non-marketable investments, short-term debt, long-term debt, swaps, currency forward contracts, equity options and warrants are based on quoted market prices or pricing models using current market rates. Debt securities are generally valued using discounted cash flows in a yield-curve model based on LIBOR. Equity options and warrants are priced using a Black-Scholes option pricing model. For the company's portfolio of non-marketable equity securities, management believes that the carrying value of the portfolio approximates the fair value at December 27, 2003 and December 28, 2002. This estimate takes into account the decline of the equity and venture capital markets over the last few years, the impairment analyses performed and the impairments recorded during 2003 and 2002. All of the estimated fair values are management's estimates; however, when there is no readily available market, the estimated fair values may not necessarily represent the amounts that could be realized in a current transaction, and these fair values could change significantly.

Derivative Financial Instruments

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The company's primary objective for holding derivative financial instruments is to manage currency, interest rate and some equity market risks. The company's derivative instruments are recorded at fair value and are included in other current assets, other assets, other accrued liabilities or debt. The company's accounting policies for these instruments are based on whether they meet the company's criteria for designation as hedging transactions, either as cash flow or fair value hedges. A hedge of the exposure to variability in the cash flows of an asset or a liability, or of a forecasted transaction, is referred to as a cash flow hedge. A hedge of the exposure to changes in fair value of an asset or a liability, or of an unrecognized firm commitment, is referred to as a fair value hedge. The criteria for designating a derivative as a hedge include the instrument's effectiveness in risk reduction and, in most cases, a one-to-one matching of the derivative instrument to its underlying transaction. Gains and losses from changes in fair values of derivatives that are not designated as hedges for accounting purposes are recognized currently in earnings, and generally offset changes in the values of related assets, liabilities or debt.

As part of its strategic investment program, the company also acquires equity derivative instruments, such as warrants and equity conversion rights associated with debt instruments, that are not designated as hedging instruments. The gains or losses from changes in fair values of these equity derivatives are recognized in gains (losses) on equity securities, net.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Currency Risk. The company transacts business in various currencies other than the U.S. dollar, primarily the Euro and certain other European and Asian currencies. The company has established balance sheet and forecasted transaction risk management programs to protect against reductions in fair value and volatility of future cash flows caused by changes in exchange rates. The forecasted transaction risk management program includes anticipated transactions such as operating costs and expenses and capital purchases. The company may use currency forward contracts, currency options, currency interest rate swaps and currency borrowings in these risk management programs. These programs reduce, but do not always entirely eliminate, the impact of currency exchange movements.

Currency forward contracts and currency options that are used to hedge exposures to variability in anticipated non-U.S.-dollar-denominated cash flows are designated as cash flow hedges. The maturities of these instruments are generally less than 24 months. For these derivatives, the gain or loss from the effective portion of the hedge is reported as a component of other comprehensive income in stockholders' equity and is reclassified into earnings in the same period or periods in which the hedged transaction affects earnings, and within the same income statement line item as the impact of the hedged transaction. The gain or loss from the ineffective portion of the hedge in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in interest and other, net during the period of change.

Currency interest rate swaps and currency forward contracts are used to offset the currency risk of non-U.S.-dollar-denominated debt securities classified as trading assets, as well as other assets and liabilities denominated in various currencies. The maturities of these instruments are generally less than 12 months, except for derivatives hedging equity investments, which are generally five years or less. Changes in fair value of the underlying assets and liabilities are generally offset by the changes in fair value of the related derivatives, with the resulting net gain or loss, if any, recorded in interest and other, net.

Interest Rate Risk. The company's primary objective for holding investments in debt securities is to preserve principal while maximizing yields, without significantly increasing risk. To achieve this objective, the returns on a substantial majority of the company's investments in long-term fixed-rate marketable debt securities are swapped to U.S. dollar LIBOR-based returns, using interest rate swaps and currency interest rate swaps in transactions that are not designated as hedges for accounting purposes. The floating interest rates on the swaps are reset on a monthly, quarterly or semiannual basis. Changes in fair value of the debt securities classified as trading assets are generally offset by changes in fair value of the related derivatives, resulting in negligible net impact. The net gain or loss, if any, is recorded in interest and other, net.

The company may also enter into interest rate swap agreements to modify the interest characteristics of a portion of its outstanding long-term debt. These transactions are designated as fair value hedges. The gains or losses from the changes in fair value of the interest rate swaps, as well as the offsetting change in the hedged fair value of the long-term debt, are recognized in interest expense.

Equity Market Risk. The company may enter into transactions designated as fair value hedges using equity options, swaps or forward contracts to hedge the equity market risk of marketable securities in its portfolio of strategic equity investments once the securities are no longer considered to have strategic value. The gain or loss from the change in fair value of these equity derivatives, as well as the offsetting change in hedged fair value of the underlying equity securities, are recognized currently in gains (losses) on equity securities, net. The company may use equity derivatives in transactions not designated as hedges to offset the change in fair value of certain equity securities classified as trading assets. The company may or may not enter into transactions to reduce or eliminate the market risks of its investments in strategic equity derivatives, including warrants.

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Measurement of Effectiveness of Hedge Relationships. For currency forward contracts, effectiveness of the hedge is measured using spot rates for hedging strategies related to long-term capital purchases, and using forward rates for all other strategies, to value the forward contract and the underlying hedged transaction. For currency options and equity options, effectiveness is measured by the change in the option's intrinsic value, which represents the change from the spot price of the underlying hedged transaction compared to the option's strike price. Changes in time value of these options are not included in the assessment of effectiveness. For interest rate swaps, effectiveness is measured by offsetting the change in fair value of the long-term debt with the change in fair value of the interest rate swap.

Any ineffective portion of the hedges, as well as amounts not included in the assessment of effectiveness, are recognized currently in interest and other, net or in gains (losses) on equity securities, net, depending on the nature of the underlying asset or liability. If a

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cash flow hedge were to be discontinued because it is probable that the original hedged transaction will not occur as anticipated, the unrealized gains or losses on the related derivative would be reclassified into earnings. 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.

For all periods presented, the portion of hedging instruments' gains or losses excluded from the assessment of effectiveness and the ineffective portions of hedges had an insignificant impact on earnings for both cash flow and fair value hedges. There was no significant impact to results of operations from discontinued cash flow hedges as a result of forecasted transactions that did not occur. For all periods presented, insignificant amounts of deferred gains or losses were reclassified from accumulated other comprehensive income to depreciation expense related to the company's foreign currency capital purchase hedging program. The company estimates that less than \$10 million of net derivative gains included in other comprehensive income will be reclassified into earnings within the next 12 months.

Inventories

Inventory cost is computed on a currently adjusted standard basis (which approximates actual cost on an average or first-in, first-out basis). Work in process and finished goods inventory are determined to be saleable based on a demand forecast within a specific time horizon, generally six months or less. Inventory in excess of saleable amounts is not valued, and the remaining inventory is valued at the lower of cost or market. Inventories at fiscal year-ends were as follows:

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> |
|--------------------------|-----------------|-----------------|
| Raw materials | \$ 333 | \$ 223 |
| Work in process | 1,490 | 1,365 |
| Finished goods | 696 | 688 |
| Total inventories | \$ 2,519 | \$ 2,276 |

Property, Plant and Equipment

Property, plant and equipment, net at fiscal year-ends was as follows:

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> |
|-------------------------|-------------|-------------|
| Land and buildings | \$ 12,651 | \$ 11,374 |
| Machinery and equipment | 24,233 | 22,800 |

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| | | |
|---|------------------|------------------|
| Construction in progress | 1,808 | 2,738 |
| | <u>38,692</u> | <u>36,912</u> |
| Less accumulated depreciation | (22,031) | (19,065) |
| | <u>\$ 16,661</u> | <u>\$ 17,847</u> |
| Total property, plant and equipment, net | \$ 16,661 | \$ 17,847 |

Property, plant and equipment is 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. Reviews are regularly performed to determine whether facts and circumstances exist which indicate that the carrying amount of assets may not be recoverable or that the useful life is shorter than originally estimated. The company assesses the recoverability of its assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets (see Note 19: Impairment of Long-Lived Assets). If assets are determined to be recoverable, but the useful lives are shorter than originally estimated, the net book value of the assets is depreciated over the newly determined remaining useful lives.

Goodwill

Effective the beginning of 2002, the company discontinued amortizing the remaining goodwill balances under the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. All remaining and future acquired goodwill is subject to an impairment test in the fourth quarter of each year, or earlier if indicators of potential impairment exist, using a fair-value-based approach. See Note 16: Goodwill for a discussion of goodwill impairments.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Upon adoption of SFAS No. 141, Business Combinations, workforce-in-place no longer meets the definition of an identifiable intangible asset for acquisitions qualifying as business combinations. As a result, as of the beginning of 2002, the net book value of the company's remaining workforce-in-place of \$39 million, along with associated deferred tax liabilities of \$19 million, was reclassified to goodwill.

For 2001, reported net income of \$1,291 million would have increased by \$1,556 million to \$2,847 million, adjusted for the exclusion of goodwill and workforce-in-place amortization, net of tax effect. Reported basic earnings per share of \$0.19 in 2001 would have increased by \$0.23 per share to \$0.42 per share, and reported diluted earnings per share of \$0.19 would have increased by \$0.22 per share to \$0.41 per share.

Identified Intangible Assets

Acquisition-related intangibles include developed technology, trademarks, customer lists and workforce-in-place, and are amortized on a straight-line basis over periods ranging from 2 to 6 years. Intellectual property assets primarily represent rights acquired under technology licenses and are amortized over the periods of benefit, ranging from 2 to 10 years, generally on a straight-line basis. All identified intangible assets are classified within other assets on the balance sheet. In the quarter following the period in which identified intangible assets become fully amortized, the fully amortized balances are removed from the gross asset and accumulated amortization amounts.

The company performs a quarterly review of its identified intangible assets to determine if facts and circumstances exist which indicate that the useful life is shorter than originally estimated or that the carrying amount of assets may not be recoverable. If such facts and circumstances do exist, the company assesses the recoverability of identified intangible assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

Revenue Recognition

The company recognizes net revenue when the earnings process is complete, as evidenced by an agreement with the customer, transfer of title and acceptance, if applicable, as well as fixed pricing and probable collectibility. Because of frequent sales price reductions and rapid technology obsolescence in the industry, sales made to distributors under agreements allowing price protection and/or right of return are deferred until the distributors sell the merchandise. Shipping charges billed to customers are included in net revenue, and the related shipping costs are included in cost of sales.

Product Warranty

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The company generally sells products with a limited warranty of product quality and a limited indemnification of customers against intellectual property infringement claims related to the company's products. The company accrues for known warranty and indemnification issues if a loss is probable and can be reasonably estimated, and accrues for estimated incurred but unidentified issues based on historical activity. The accrual and the related expense for known issues were not significant during the periods presented. Due to product testing, the short time between product shipment and the detection and correction of product failures, and a low historical rate of payments on indemnification claims, the accrual and related expense for estimated incurred but unidentified issues were not significant during the periods presented.

Advertising

Cooperative advertising obligations are accrued and the costs expensed at the same time the related revenue is recognized. All other advertising costs are expensed as incurred. Cooperative advertising expenses are recorded as marketing, general and administrative expense to the extent that an advertising benefit separate from the revenue transaction can be identified and the cash paid does not exceed the fair value of that advertising benefit received. Any excess of cash paid over the fair value of the advertising benefit received is recorded as a reduction of revenue. Advertising expense was \$1.8 billion in 2003 (\$1.7 billion in 2002 and \$1.6 billion in 2001).

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Employee Stock Benefit Plans**

The company has employee stock benefit plans, which are described more fully in Note 12: Employee Stock Benefit Plans. The company's stock option plans are accounted for under the intrinsic value recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. Because the exercise price of all options granted under these stock option plans was equal to the market price of the underlying common stock (defined as the average of the high and low trading prices reported by The NASDAQ Stock Market*) on the grant date, no stock-based employee compensation, other than acquisition-related compensation, is recognized in net income. The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended, to options granted under the stock option plans and rights to acquire stock granted under the company's Stock Participation Plan, collectively called options. For purposes of this pro-forma disclosure, the value of the options is estimated using a Black-Scholes option pricing model and amortized ratably to expense over the options' vesting periods. Because the estimated value is determined as of the date of grant, the actual value ultimately realized by the employee may be significantly different.

| (In Millions Except Per Share Amounts) | 2003 | 2002 | 2001 |
|---|-------------|-------------|-------------|
| Net income, as reported | \$ 5,641 | \$ 3,117 | \$ 1,291 |
| Less: Total stock-based employee compensation expense determined under the fair value method for all awards, net of tax | 991 | 1,170 | 1,037 |
| Pro-forma net income | \$ 4,650 | \$ 1,947 | \$ 254 |
| Reported basic earnings per common share | \$ 0.86 | \$ 0.47 | \$ 0.19 |
| Reported diluted earnings per common share | \$ 0.85 | \$ 0.46 | \$ 0.19 |
| Pro-forma basic earnings per common share | \$ 0.71 | \$ 0.29 | \$ 0.04 |
| Pro-forma diluted earnings per common share | \$ 0.71 | \$ 0.29 | \$ 0.04 |

It is the company's policy under SFAS No. 123 to periodically make adjustments to pro-forma compensation expense to reflect forfeitures. Based on recent forfeiture data, the company reversed previously recognized pro-forma compensation expense and related tax effects totaling \$190 million in 2003 (\$87 million in 2002 and \$93 million in 2001).

SFAS No. 123 requires the use of option pricing models that were not developed for use in valuing employee stock options. The Black-Scholes option pricing model was developed for use in estimating the fair value of short-lived exchange-traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. Because the company's employee stock 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 employee stock options. See Note 12: Employee Stock Benefit Plans for a discussion of the assumptions used in the option pricing model and estimated fair value of employee

stock options.

Recent Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, in January 2003 and amended the Interpretation in December 2003. FIN 46 requires an investor with a majority of the variable interests (primary beneficiary) in a variable interest entity (VIE) to consolidate the entity and also requires majority and significant variable interest investors to provide certain disclosures. A VIE is an entity in which the voting equity investors do not have a controlling financial interest or the equity investment at risk is insufficient to finance the entity's activities without receiving additional subordinated financial support from the other parties. Development-stage entities that have sufficient equity invested to finance the activities they are currently engaged in and entities that are businesses, as defined in the Interpretation, are not considered VIEs. The provisions of FIN 46 were effective immediately for all arrangements entered into with new VIEs created after January 31, 2003, and Intel has elected to apply the remaining provisions of the Interpretation for the period ending December 27, 2003. Intel has completed a review of its investments in both non-marketable and marketable equity securities as well as other arrangements to determine whether Intel is the primary beneficiary of any VIEs. The review did not identify any VIEs that would require consolidation or any significant exposure to VIEs that would require disclosure.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 3: Earnings Per Share**

The shares used in the computation of the company's basic and diluted earnings per common share were as follows:

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|--------------|--------------|--------------|
| Weighted average common shares outstanding | 6,527 | 6,651 | 6,716 |
| Dilutive effect of employee stock options | 94 | 108 | 163 |
| Weighted average common shares outstanding, assuming dilution | 6,621 | 6,759 | 6,879 |

Weighted average common shares outstanding, assuming dilution, include the incremental shares that would be issued upon the assumed exercise of stock options. For 2003, approximately 418 million of the company's stock options were excluded from the calculation of diluted earnings per share because the exercise prices of the stock options were greater than or equal to the average price of the common shares, and therefore their inclusion would have been anti-dilutive (387 million in 2002 and 211 million in 2001). These options could be dilutive in the future if the average share price increases and is equal to or greater than the exercise price of these options.

Note 4: Common Stock Repurchase Program

The company has an ongoing authorization, as amended, from the Board of Directors to repurchase up to 2.3 billion shares of Intel's common stock in open market or negotiated transactions. During 2003, the company repurchased 176 million shares of common stock at a cost of \$4 billion. During 2002, the company repurchased 183 million shares of common stock at a cost of \$4 billion (133 million shares at a cost of \$4 billion during 2001). Since the program began in 1990, the company has repurchased and retired approximately 1.9 billion shares at a cost of \$34 billion. As of December 27, 2003, approximately 414 million shares remained available for repurchase under the existing repurchase authorization.

Note 5: Borrowings***Short-Term Debt***

Short-term debt at fiscal year-ends was as follows:

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| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> |
|---|---------------|---------------|
| Drafts payable (non-interest-bearing) | \$ 143 | \$ 211 |
| Floating rate obligations under securities lending agreements | | 84 |
| Current portion of long-term debt | 81 | 141 |
| Total short-term debt | \$ 224 | \$ 436 |

Obligations under securities lending agreements had an average rate of 1.25% as of December 28, 2002. The company also borrows under a commercial paper program. Maximum borrowings under the company's commercial paper program reached \$30 million during 2003 and \$240 million during 2002, and cannot exceed authorized borrowings of \$3 billion. No commercial paper was outstanding as of December 27, 2003 or December 28, 2002. The company's commercial paper is rated A-1+ by Standard & Poor's and P-1 by Moody's.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Long-Term Debt**

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

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> |
|---|---------------|---------------|
| Payable in U.S. dollars: | | |
| Puerto Rico bonds adjustable 2003, due 2013 at 3.9% 4.25% | \$ | \$ 116 |
| Zero coupon senior exchangeable notes due 2004 | 41 | 118 |
| Other U.S. dollar debt | 1 | 3 |
| Payable in other currencies: | | |
| Euro debt due 2004 2018 at 2.3% 11% | 975 | 833 |
| | <u>1,017</u> | <u>1,070</u> |
| Less current portion of long-term debt | (81) | (141) |
| Total long-term debt | \$ 936 | \$ 929 |

In 2003, the company redeemed bonds with a principal amount of \$110 million. The bonds were issued by the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority, and the company had guaranteed payment of principal and interest.

Holders of the company's zero coupon senior exchangeable notes (Intel notes) had the right, prior to January 12, 2004, to exchange their Intel notes for Samsung Electronics Co., Ltd. convertible notes (Samsung notes) owned by Intel. The exchangeable notes were issued in order to partially mitigate the equity market risk of Intel's investment in the Samsung notes, and the exchange option has been accounted for as an equity derivative and marked-to-market with the fair value recorded in long-term debt. During 2003, the holders exchanged Intel notes with a principal amount of \$57 million (\$122 million in 2002). In accordance with the terms of the Intel notes, the company delivered a portion of its investment in the Samsung notes with a face value of approximately \$29 million to the holders in exchange for Intel notes (\$61 million in 2002). The carrying value of the debt instrument, excluding the portion allocated to the equity derivative, is being accreted to its remaining principal amount of \$21 million through interest expense over the period to its maturity. The Intel notes are classified as short-term debt at December 27, 2003. Subsequent to December 27, 2003, substantially all of the remaining Intel note holders have exercised their right to exchange their Intel notes for Samsung notes owned by Intel.

The Euro borrowings were made in connection with the financing of manufacturing facilities and equipment in Ireland, and Intel has invested the proceeds in Euro-denominated instruments of similar maturity to hedge currency and interest rate exposures.

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As of December 27, 2003, aggregate debt maturities were as follows: 2004 \$81 million; 2005 \$48 million; 2006 \$54 million; 2007 \$58 million; 2008 \$140 million; and thereafter \$636 million.

Note 6: Investments

Trading Assets

Trading assets outstanding at fiscal year-ends were as follows:

| <u>(In Millions)</u> | 2003 | | 2002 | |
|--|---------------|-----------------|---------------|-----------------|
| | Net | | Net | |
| | Unrealized | Estimated | Unrealized | |
| | Gains | Fair Value | Gains | Estimated |
| | Gains | Fair Value | (Losses) | Fair Value |
| Debt instruments | \$ 174 | \$ 2,321 | \$ 64 | \$ 1,460 |
| Equity securities | | | 63 | 98 |
| Equity securities offsetting deferred compensation | 60 | 304 | (1) | 243 |
| Total trading assets | \$ 234 | \$ 2,625 | \$ 126 | \$ 1,801 |

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Net holding gains (losses) on fixed income debt instruments classified as trading assets were \$208 million in 2003, \$79 million in 2002 and \$(21) million in 2001. Net holding gains (losses) on the related derivatives were \$(192) million in 2003, \$(75) million in 2002 and \$21 million in 2001. These amounts were included in interest and other, net in the consolidated statements of income.

Net holding gains on equity security trading assets were \$77 million in 2003, \$57 million in 2002 and \$72 million in 2001. The \$57 million net gain in 2002 includes a gain of \$120 million that resulted from the designation of formerly restricted equity investments as trading assets as they became marketable. The cumulative difference between their cost and fair market value at the time they became marketable was recorded as a gain in 2002. Net holding gains (losses) on the related derivatives were \$(84) million in 2003, \$110 million in 2002 and \$18 million in 2001. These gains and losses were included within losses on equity securities, net in the consolidated statements of income.

Certain equity securities within the trading asset portfolio are maintained to generate returns that seek to offset changes in liabilities related to the equity market risk of certain deferred compensation arrangements. These deferred compensation liabilities were \$427 million in 2003 and \$336 million in 2002, and are included in other accrued liabilities on the consolidated balance sheets. Net holding gains (losses) on equity securities offsetting deferred compensation arrangements were \$52 million in 2003, \$(64) million in 2002 and \$(45) million in 2001, and were included within interest and other, net in the consolidated statements of income.

Available-for-Sale Investments

Available-for-sale investments at December 27, 2003 were as follows:

| (In Millions) | Adjusted Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|------------------|------------------------------|-------------------------------|----------------------------|
| Commercial paper | \$ 9,948 | \$ | \$ (1) | \$ 9,947 |
| Bank time deposits | 1,900 | | | 1,900 |
| Floating rate notes | 1,078 | | | 1,078 |
| Loan participations | 985 | | | 985 |
| Corporate bonds | 703 | | | 703 |
| Marketable strategic equity securities | 467 | 47 | | 514 |
| Preferred stock and other equity | 224 | 9 | | 233 |
| Other debt securities | 352 | | | 352 |
| Total available-for-sale investments | 15,657 | 56 | (1) | 15,712 |
| Less amounts classified as cash equivalents | (7,764) | | | (7,764) |
| | \$ 7,893 | \$ 56 | \$ (1) | \$ 7,948 |

Available-for-sale investments at December 28, 2002 were as follows:

| (In Millions) | Adjusted Cost | Gross | | Estimated Fair Value |
|---|------------------|---------------------|----------------------|-------------------------|
| | | Unrealized Gains | Unrealized Losses | |
| Commercial paper | \$ 6,935 | \$ 1 | \$ | \$ 6,936 |
| Bank time deposits | 2,121 | 1 | | 2,122 |
| Loan participations | 862 | | | 862 |
| Corporate bonds | 838 | | | 838 |
| Floating rate notes | 781 | | (1) | 780 |
| Preferred stock and other equity | 140 | | | 140 |
| Other debt securities | 71 | | | 71 |
| Marketable strategic equity securities | 38 | 19 | (1) | 56 |
| Total available-for-sale investments | 11,786 | 21 | (2) | 11,805 |
| Less amounts classified as cash equivalents | (7,189) | | | (7,189) |
| | \$ 4,597 | \$ 21 | \$ (2) | \$ 4,616 |

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The company sold available-for-sale securities with a fair value at the date of sale of \$39 million in 2003, \$114 million in 2002 and \$1.3 billion in 2001. The gross realized gains on these sales totaled \$16 million in 2003, \$15 million in 2002 and \$548 million in 2001. The company realized gross losses on sales of less than \$1 million in 2003, \$39 million in 2002 and \$187 million in 2001. The company recognized gains on shares exchanged in third-party merger transactions of \$7 million in 2003, \$1 million in 2002 and \$156 million in 2001. The company recognized impairment losses on available-for-sale and non-marketable investments of \$319 million in 2003, \$524 million in 2002 and \$1.1 billion in 2001.

The amortized cost and estimated fair value of available-for-sale investments in debt securities at December 27, 2003, by contractual maturity, were as follows:

| <u>(In Millions)</u> | <u>Cost</u> | <u>Estimated Fair Value</u> |
|--|------------------|---------------------------------|
| Due in 1 year or less | \$ 13,120 | \$ 13,119 |
| Due in 1 - 2 years | 842 | 842 |
| Due in 2 - 5 years | 378 | 378 |
| Due after 5 years | 626 | 626 |
| Total investments in available-for-sale debt securities | \$ 14,966 | \$ 14,965 |

Note 7: Fair Values of Financial Instruments

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

| <u>(In Millions - Assets (Liabilities))</u> | <u>2003</u> | | <u>2002</u> | |
|---|----------------------------|-------------------------------------|----------------------------|---------------------------------|
| | <u>Carrying Amount</u> | <u>Estimated Fair Value</u> | <u>Carrying Amount</u> | <u>Estimated Fair Value</u> |
| Cash and cash equivalents | \$ 7,971 | \$ 7,971 | \$ 7,404 | \$ 7,404 |
| Short-term investments | \$ 5,568 | \$ 5,568 | \$ 3,382 | \$ 3,382 |
| Trading assets | \$ 2,625 | \$ 2,625 | \$ 1,801 | \$ 1,801 |
| Marketable strategic equity securities | \$ 514 | \$ 514 | \$ 56 | \$ 56 |
| Other long-term investments | \$ 1,866 | \$ 1,866 | \$ 1,178 | \$ 1,178 |
| Non-marketable equity investments | \$ 665 | \$ 665 | \$ 730 | \$ 730 |

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| | | | | |
|-------------------------------------|----------|----------|----------|----------|
| Other non-marketable investments | \$ 32 | \$ 32 | \$ 92 | \$ 92 |
| Derivatives recorded as assets | \$ 134 | \$ 134 | \$ 278 | \$ 278 |
| Derivatives recorded as liabilities | \$ (178) | \$ (178) | \$ (89) | \$ (89) |
| Short-term debt | \$ (224) | \$ (224) | \$ (436) | \$ (432) |
| Long-term debt | \$ (936) | \$ (936) | \$ (929) | \$ (929) |

Note 8: Concentrations of Credit Risk

Financial instruments that potentially subject the company to concentrations of credit risk consist principally of investments in debt securities, derivative financial instruments and trade receivables. Intel generally 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. Investments in debt securities with original maturities of greater than six months consist primarily of A and A2 or better rated financial instruments and counterparties. Investments with original maturities of up to six months consist primarily of A-1 and P-1 or better rated financial instruments and counterparties. Government regulations imposed on investment alternatives of Intel's non-U.S. subsidiaries, or the absence of A and A2 rated counterparties in certain countries, result in some minor exceptions, which are reviewed and approved by the Board of Directors annually. Credit rating criteria for derivative instruments are similar to those for investments. The amounts subject to credit risk related to derivative instruments are generally limited to the amounts, if any, by which a counterparty's obligations exceed the obligations of Intel with that counterparty. At December 27, 2003, debt investments were placed with approximately 220 different counterparties. Intel's practice is to obtain and secure available collateral from counterparties against obligations, including securities lending transactions, whenever Intel deems appropriate.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A majority of the company's trade receivables are derived from sales to original equipment manufacturers and original design manufacturers of computer systems, cellular handsets and handheld computing devices, networking and communications equipment, and peripherals. The company's three largest customers accounted for approximately 42% of net revenue for 2003, an increase from 38% for 2002 (35% of net revenue for 2001). At December 27, 2003, the three largest customers accounted for approximately 43% of net accounts receivable (39% of net accounts receivable at December 28, 2002).

The company has adopted credit policies and standards intended to accommodate industry growth and inherent risk. Management believes that credit risks are moderated by the financial stability of the company's end customers and the diverse geographic sales areas. To assess the credit risk of counterparties, a quantitative and qualitative analysis is performed. From this analysis, credit limits are established and a determination is made whether one or more credit support devices, such as obtaining some form of third-party guaranty or standby letter of credit, or obtaining credit insurance for all or a portion of the account balance, is necessary.

Note 9: Interest and Other, Net

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|-------------------------------|---------------|---------------|---------------|
| Interest income | \$ 248 | \$ 298 | \$ 615 |
| Interest expense | (62) | (84) | (56) |
| Loss on investment in Convera | | | (196) |
| Other, net | 6 | (20) | 30 |
| Total | \$ 192 | \$ 194 | \$ 393 |

Effective as of the beginning of 2001, the company adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. The cumulative effect of the adoption of SFAS No. 133 was an increase in income before taxes of \$45 million, which was included in other, net for 2001.

During 2001, Intel recorded a loss of approximately \$39 million as its proportionate share of the net loss of Convera Corporation, accounted for as an equity-method investment, and recognized a combined net loss of \$157 million on the impairment and subsequent sale of the remaining investment in Convera.

Note 10: Comprehensive Income

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

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| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|--------------|--------------|-----------------|
| Change in net unrealized holding gain on investments, net of tax of \$(18), \$24 and \$187 in 2003, 2002 and 2001, respectively | \$ 33 | \$ (44) | \$ (347) |
| Less: adjustment for net gain or loss on investments included in net income, net of tax of \$5, \$(14) and \$(99) in 2003, 2002 and 2001, respectively | (11) | 25 | 184 |
| Change in net unrealized holding gain on derivatives, net of tax of \$(15), \$(23) and \$4 in 2003, 2002 and 2001, respectively | 27 | 43 | (7) |
| Less: adjustment for amortization of net gain on derivatives included in net income, net of tax | (1) | | |
| Minimum pension liability, net of tax of \$(2) and \$2 in 2003 and 2002, respectively | 5 | (6) | |
| | <u>\$ 53</u> | <u>\$ 18</u> | <u>\$ (170)</u> |

The components of accumulated other comprehensive income, net of tax, were as follows:

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> |
|---|---------------------|---------------------|
| Accumulated net unrealized holding gain on available-for-sale investments | \$ 35 | \$ 13 |
| Accumulated net unrealized holding gain on derivatives | 62 | 36 |
| Accumulated minimum pension liability | (1) | (6) |
| Total accumulated other comprehensive income | <u>\$ 96</u> | <u>\$ 43</u> |

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 11: Provision for Taxes

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

| (Dollars in Millions) | 2003 | 2002 | 2001 |
|----------------------------------|-----------------|-----------------|-----------------|
| Income (loss) before taxes: | | | |
| U.S. | \$ 5,705 | \$ 2,165 | \$ (350) |
| Non-U.S. | 1,737 | 2,039 | 2,533 |
| Total income before taxes | \$ 7,442 | \$ 4,204 | \$ 2,183 |
| Provision for taxes: | | | |
| Federal: | | | |
| Current | \$ 808 | \$ 542 | \$ 903 |
| Deferred | 420 | 91 | (417) |
| | 1,228 | 633 | 486 |
| State: | | | |
| Current | 223 | 143 | 142 |
| Non-U.S.: | | | |
| Current | 379 | 292 | 366 |
| Deferred | (29) | 19 | (102) |
| | 350 | 311 | 264 |
| Total provision for taxes | \$ 1,801 | \$ 1,087 | \$ 892 |
| Effective tax rate | 24.2% | 25.9% | 40.9% |

The tax benefit associated with dispositions from employee stock plans reduced taxes currently payable for 2003 by \$216 million (\$270 million for 2002 and \$435 million for 2001).

The difference between the tax provision at the statutory federal income tax rate and the tax provision attributable to income before income taxes was as follows:

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| <u>(In Percentages)</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|---|--------------|--------------|--------------|
| Statutory federal income tax rate | 35.0% | 35.0% | 35.0% |
| Increase (reduction) in rate resulting from: | | | |
| State taxes, net of federal benefits | 1.9 | 2.2 | 4.2 |
| Non-U.S. income taxed at different rates | (2.8) | (5.9) | (15.4) |
| Non-deductible acquisition-related costs and goodwill impairments | 3.1 | 1.3 | 30.6 |
| Tax benefit related to divestitures | (10.2) | (1.8) | |
| Export sales benefit | (2.5) | (3.0) | (11.2) |
| Other | (0.3) | (1.9) | (2.3) |
| Income tax rate | 24.2% | 25.9% | 40.9% |

The company reduced its tax provision for 2003 by approximately \$758 million due to the tax benefits related to the sale of certain businesses and assets through the sale of stock of acquired companies (\$75 million in 2002). See Note 14: Business Combinations and Divestitures.

The company reduced its tax provision for 2001 by \$100 million due to an increase in the tax benefit related to export sales for 2000, including the impact of a revision in the tax law. This change in estimated taxes was reflected in the federal tax return for 2000 filed in 2001.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During 2001, the Internal Revenue Service (IRS) commenced an examination of Intel's tax returns for the years 1999 and 2000. In August 2003, the IRS proposed certain adjustments to the amounts reflected by Intel on these returns as a tax benefit for its export sales (see Note 21: Contingencies). In January 2004, the IRS commenced an examination of Intel's tax returns for the years 2001 and 2002. Although the outcome of tax audits is always uncertain, based on currently available information, management believes that the ultimate outcome will not have a material adverse effect on the company's financial position, cash flows or overall trends in results of operations.

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:

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> |
|---|-----------------|----------------|
| Deferred tax assets | | |
| Accrued compensation and benefits | \$ 218 | \$ 199 |
| Accrued advertising | 107 | 96 |
| Deferred income | 245 | 199 |
| Inventory valuation | 156 | 184 |
| Impairment losses on equity investments | 106 | 319 |
| Other, net | 137 | 139 |
| | <u>969</u> | <u>1,136</u> |
| Deferred tax liabilities | | |
| Depreciation | (1,272) | (948) |
| Acquired intangibles | (68) | (120) |
| Unremitted earnings of certain subsidiaries | (86) | (112) |
| Unrealized gains on investments | (50) | (45) |
| Other, net | (6) | (7) |
| | <u>(1,482)</u> | <u>(1,232)</u> |
| Net deferred tax liability | \$ (513) | \$ (96) |

U.S. income taxes were not provided for on a cumulative total of approximately \$7.0 billion of undistributed earnings for certain non-U.S. subsidiaries. The company intends to reinvest these earnings indefinitely in operations outside the U.S.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 12: Employee Stock Benefit Plans*Stock Option Plans*

The company 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. This plan expires in May 2004. The company also has a broad-based stock option plan under which stock options may be granted to all employees other than officers and directors. This plan expires in January 2007. As of December 27, 2003, substantially all of our employees were participating in one of the stock option plans. The company presently expects to propose a new equity plan for stockholder vote at its May 2004 Annual Stockholders Meeting. Contingent on stockholder approval, this new equity plan would replace both of the existing plans. The company's Executive Long-Term Stock Option Plan, under which certain key employees, including officers, were granted stock options, terminated in 1998. In prior years, Intel also assumed the stock option plans and the outstanding options of certain acquired companies. No additional stock grants will be made under the Executive Long-Term Stock Option Plan or the assumed plans. Options granted by Intel currently expire no later than 10 years from the grant date. Options granted in 2003 to existing and newly hired employees generally vest in increments over four or five years from the date of grant, and certain grants to key employees have delayed vesting, generally beginning six years from the date of grant. Additional information with respect to stock option plan activity is as follows:

| (Shares in Millions) | Shares Available for Grant | Outstanding Options | |
|---------------------------------|----------------------------------|---------------------|---------------------------------------|
| | | Number of Shares | Weighted Average Exercise Price |
| December 30, 2000 | 347.6 | 638.2 | \$ 24.16 |
| Supplemental grant | (51.9) | 51.9 | \$ 25.69 |
| 2002 merit grant | (67.6) | 67.6 | \$ 24.37 |
| Other grants | (118.6) | 118.6 | \$ 25.48 |
| Options assumed in acquisitions | | 9.0 | \$ 19.25 |
| Exercises | | (68.0) | \$ 6.06 |
| Cancellations | 45.1 | (48.8) | \$ 35.01 |
| Additional shares reserved | 900.0 | | |
| December 29, 2001 | 1,054.6 | 768.5 | \$ 25.33 |
| Supplemental grant | (118.1) | 118.1 | \$ 20.23 |
| Other grants | (55.5) | 55.5 | \$ 25.43 |
| Exercises | | (51.4) | \$ 6.79 |
| Cancellations | 40.8 | (45.3) | \$ 33.56 |
| December 28, 2002 | 921.8 | 845.4 | \$ 25.31 |
| Grants | (109.9) | 109.9 | \$ 20.22 |
| Exercises | | (63.7) | \$ 10.08 |
| Cancellations | 40.0 | (41.5) | \$ 30.49 |

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| | | | |
|---|--------------|--------------|-----------------|
| Reduction in shares available for grant | (325.0) | | |
| December 27, 2003 | 526.9 | 850.1 | \$ 25.54 |
| Options exercisable at: | | | |
| December 29, 2001 | | 230.9 | \$ 11.27 |
| December 28, 2002 | | 274.0 | \$ 16.57 |
| December 27, 2003 | | 327.5 | \$ 20.53 |

In December 2003, the Board of Directors approved a reduction in the number of shares authorized for issuance under the broad-based stock option plan, reducing the number of shares available for issuance by 325 million. This amount was not expected to be utilized for future grants, after taking into account the current average run-rate of grants per year and the remaining life of the plan.

In November 2002, a supplemental stock option grant was given to employees who had previously been granted options in 2001 and 2000 that had exercise prices above the November 2002 market price. This 2002 supplemental grant was made in order to retain employees, due to competitive market conditions and a decline in the company's stock price. The 2002 supplemental options vest in equal amounts over four years. A supplemental stock grant was also made in 2001, vesting in equal amounts in 2002 and 2003.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During 2001, the company granted merit-based options that would typically have been granted in 2002, in order to enhance the potential long-term retention value of these stock options. This grant is referred to in the table above as 2002 merit grant. The 2002 merit grant vests in 2007, on about the same date that the options would vest if they had been granted in 2002. Merit grants made in 2002, included in other grants in the table above, were reduced by the shares granted in this early grant program during 2001.

The range of option exercise prices for options outstanding at December 27, 2003 was \$0.01 to \$87.90. This range reflects the impact of options assumed with acquired companies in addition to the fluctuating price of Intel common stock.

The following table summarizes information about options outstanding at December 27, 2003:

| Range of Exercise Prices | Outstanding Options | | | Exercisable Options | |
|--------------------------|---------------------|------------------|------------------|---------------------|---------------------------------|
| | Number of Shares | Contractual Life | Weighted Average | Number of Shares | Weighted Average Exercise Price |
| | (In Millions) | (In Years) | Exercise Price | (In Millions) | Price |
| \$0.01 \$17.40 | 115.4 | 3.0 | \$ 8.57 | 94.3 | \$ 7.13 |
| \$17.41 \$20.17 | 193.6 | 6.3 | \$ 18.48 | 103.2 | \$ 18.34 |
| \$20.23 \$24.35 | 263.1 | 8.0 | \$ 22.38 | 37.6 | \$ 20.97 |
| \$24.37 \$31.35 | 126.6 | 7.1 | \$ 28.63 | 46.9 | \$ 26.44 |
| \$31.37 \$45.16 | 70.4 | 7.1 | \$ 37.06 | 30.5 | \$ 38.46 |
| \$45.96 \$87.90 | 81.0 | 6.3 | \$ 61.96 | 15.0 | \$ 63.74 |
| Total | 850.1 | 6.5 | \$ 25.54 | 327.5 | \$ 20.53 |

These options will expire if not exercised at specific dates through October 2013. Option exercise prices for options exercised during the three-year period ended December 27, 2003 ranged from \$0.01 to \$36.47.

Stock Participation Plan

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In addition to the employee stock option plans, the company has a Stock Participation Plan, under which eligible employees may purchase shares of Intel's common stock at 85% of the average of the high and low stock price reported on The NASDAQ Stock Market* at specific, predetermined dates. Approximately 75% of the company's employees were participating in the Stock Participation Plan as of December 27, 2003. Of the 944 million shares authorized to be issued under the plan, 85.9 million shares remained available for issuance at December 27, 2003. Employees purchased 23.8 million shares in 2003 (17.0 million in 2002 and 13.0 million in 2001) for \$328 million (\$338 million in 2002 and \$351 million in 2001).

SFAS No. 123 Assumptions and Fair Value

The effect on net income and earnings per share if the company had applied the recognition provision of SFAS No. 123 is reported in Note 2: Accounting Policies.

The weighted average estimated fair value of employee stock options granted during 2003 was \$9.02 (\$10.89 in 2002 and \$12.62 in 2001). The fair value of options granted in 2003, 2002 and 2001 was estimated at the date of grant using the following weighted average assumptions:

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--------------------------|-------------|-------------|-------------|
| Expected life (in years) | 4.4 | 6.0 | 6.0 |
| Risk-free interest rate | 2.2% | 3.7% | 4.9% |
| Volatility | .54 | .49 | .47 |
| Dividend yield | .4% | .3% | .3% |

An analysis of historical information is used to determine the company's assumptions, to the extent that historical information is relevant, based on the terms of the grants being issued in any given period. The expected life for options granted in 2003 reflects

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options granted to existing employees that now generally vest ratably over four years from the date of grant. Options granted to existing employees during 2002 and prior years generally vest five years from the date of grant.

Under the Stock Participation Plan, rights to purchase shares are granted during the first and third quarter of each year. The estimated weighted average value of rights granted under the Stock Participation Plan during 2003 was \$5.65 (\$7.23 during 2002 and \$8.97 in 2001). The fair value of rights granted during 2003, 2002 and 2001 was estimated at the date of grant using the following weighted average assumptions:

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--------------------------|-------------|-------------|-------------|
| Expected life (in years) | .5 | .5 | .5 |
| Risk-free interest rate | 1.1% | 1.8% | 4.1% |
| Volatility | .50 | .50 | .54 |
| Dividend yield | .4% | .3% | .3% |

Note 13: Retirement Benefit Plans***Profit Sharing Plans***

The company provides tax-qualified profit-sharing retirement plans for the benefit of eligible employees, former employees and retirees in the U.S. and certain other 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. Amounts to be contributed are determined by the Chief Executive Officer of the company under delegation of authority from the Board of Directors, pursuant to the terms of the Profit Sharing Plan. Substantially all of the assets as of December 27, 2003 have been allocated to an equity index fund managed by an outside fund manager, consistent with the investment policy for the Profit Sharing Plan.

The company also provides a non-qualified profit-sharing retirement plan for the benefit of eligible employees in the U.S. This plan is designed to permit certain discretionary employer contributions and to permit employee deferral of a portion of salaries in excess of certain tax limits and deferral of bonuses. This plan is unfunded.

The company expensed \$302 million for the qualified and non-qualified profit-sharing retirement plans in 2003 (\$303 million in 2002 and \$190 million in 2001). The company expects to fund approximately \$291 million for the 2003 contribution to the qualified plan and to allocate approximately \$3 million for the non-qualified profit-sharing retirement plan.

Contributions made by the company on behalf of the employees 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.

Pension and Postretirement Benefit Plans

U.S. Pension Benefits. The company provides a tax-qualified defined-benefit pension plan for the benefit of eligible employees and retirees in the U.S. The plan provides for a minimum pension benefit that is 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 Profit Sharing Plan. If the pension benefit exceeds the participant's balance in the Profit Sharing Plan, the participant will receive a combination of pension and profit-sharing amounts equal to the pension benefit. However, the participant will receive only the benefit from the Profit Sharing Plan if such benefit is greater than the value of the pension benefit. The U.S. defined-benefit plan's projected benefit obligation assumes future contributions to the Profit Sharing Plan, and if the company does not continue to contribute to or significantly reduces contributions to the Profit Sharing Plan, the U.S. defined-benefit plan projected benefit obligation could increase significantly. Historically, the company has contributed 8% to 12.5% of participants' eligible compensation to the Profit Sharing Plan on an annual basis. The benefit obligation and related assets under this plan have been measured as of November 30, 2003.

Non-U.S. Pension Benefits. The company also provides defined-benefit pension plans in certain other countries. The company deposits funds for certain of these plans, consistent with the requirements of local law, with insurance companies, third-party trustees, or into government-managed accounts, and/or accrues for the unfunded portion of the obligation. The assumptions used in calculating

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the obligation for the non-U.S. plans depend on the local economic environment. The benefit obligations and related assets under these plans have been measured as of December 27, 2003.

Postretirement Medical Benefits. Upon retirement, eligible U.S. 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.

Funding Policy. The company's practice is to fund the various pension plans in amounts at least sufficient to meet the minimum requirements of U.S. federal laws and regulations or applicable local laws and regulations. The assets of the various plans are invested in corporate equities, corporate debt securities, government securities and other institutional arrangements. The portfolio of each plan depends on plan design and applicable local laws. Depending on the design of the plan, and local custom and market circumstances, the minimum liabilities of a plan may exceed qualified plan assets. The company accrues for all such liabilities.

Benefit Obligation and Plan Assets

The changes in the benefit obligations, plan assets and funded status for the plans described above were as follows:

| (In Millions) | U.S. Pension Benefits | | Non-U.S. Pension Benefits | | Postretirement Medical Benefits | |
|--|-----------------------|--------------|---------------------------|---------------|---------------------------------|---------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| Change in projected benefit obligation: | | | | | | |
| Beginning projected benefit obligation | \$ 28 | \$ 15 | \$ 242 | \$ 194 | \$ 132 | \$ 101 |
| Service cost | 5 | 3 | 26 | 23 | 12 | 10 |
| Interest cost | 3 | 2 | 18 | 14 | 10 | 8 |
| Plan participants' contributions | | | 3 | 4 | | |
| Actuarial (gain) loss | 14 | 9 | (15) | 8 | 28 | 16 |
| Currency exchange rate changes | | | 37 | 8 | | |
| Benefits paid to plan participants | (1) | (1) | (5) | (9) | (4) | (3) |
| Ending projected benefit obligation | \$ 49 | \$ 28 | \$ 306 | \$ 242 | \$ 178 | \$ 132 |
| | | | | | | |
| (In Millions) | U.S. Pension Benefits | | Non-U.S. Pension Benefits | | Postretirement Medical Benefits | |
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |

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The amounts recognized on the balance sheet for the plans described above were as follows:

| (In Millions) | U.S. Pension Benefits | | Non-U.S. Pension Benefits | | Postretirement Medical Benefits | |
|---|-----------------------|-------------|---------------------------|----------------|---------------------------------|----------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| | — | — | — | — | — | — |
| Amounts recognized in the balance sheet: | | | | | | |
| Prepaid benefit cost | \$ | \$ 4 | \$ 25 | \$ 14 | \$ | \$ |
| Accrued benefit liability | | | (103) | (82) | (107) | (85) |
| Deferred tax asset | | | | 2 | | |
| Accumulated other comprehensive income | | | 1 | 6 | | |
| Net amount recognized | \$ | \$ 4 | \$ (77) | \$ (60) | \$ (107) | \$ (85) |

The accumulated benefit obligations for the plans were as follows:

| (In Millions) | U.S. Pension Benefits | | Non-U.S. Pension Benefits | | Postretirement Medical Benefits | |
|--------------------------------|-----------------------|-------|---------------------------|--------|---------------------------------|--------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| | — | — | — | — | — | — |
| Accumulated benefit obligation | \$ 28 | \$ 17 | \$ 224 | \$ 167 | \$ 178 | \$ 132 |

Included in the aggregate data in the tables below are the aggregate amounts applicable to the company's pension plans with accumulated benefit obligations in excess of plan assets as well as plans with projected benefit obligations in excess of plan assets. Amounts related to such plans were as follows:

| (In Millions) | U.S. Pension Benefits | | Non-U.S. Pension Benefits | |
|---|-----------------------|------|---------------------------|------|
| | 2003 | 2002 | 2003 | 2002 |
| | — | — | — | — |
| Plans with accumulated benefit obligations in excess of plan assets: | | | | |

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| | | | | | |
|---|-------|-------|--------|--------|-------|
| Accumulated benefit obligations | | | | \$ 148 | \$ 68 |
| Plan assets | | | | \$ 87 | \$ 25 |
| Plans with projected benefit obligations in excess of plan assets: | | | | | |
| Projected benefit obligations | \$ 49 | \$ 28 | \$ 306 | \$ 242 | |
| Plan assets | \$ 30 | \$ 23 | \$ 195 | \$ 140 | |

Assumptions

Weighted-average actuarial assumptions used to determine benefit obligations for the plans were as follows:

| | U.S. Pension | | Non-U.S. Pension | | Postretirement Medical | |
|-------------------------------------|--------------|------|------------------|------|------------------------|------|
| | Benefits | | Benefits | | Benefits | |
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| Discount rate | 6.0% | 7.0% | 5.5% | 7.9% | 6.0% | 7.0% |
| Expected return on plan assets | 8.0% | 8.5% | 6.7% | 9.2% | | |
| Rate of compensation increase | 5.0% | 5.0% | 3.5% | 6.8% | | |
| Future profit-sharing contributions | 6.0% | 6.0% | | | | |

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Weighted-average actuarial assumptions used to determine costs for the plans were as follows:

| | U.S. Pension | | Non-U.S. Pension | | Postretirement Medical | |
|-------------------------------------|--------------|------|------------------|------|------------------------|------|
| | Benefits | | Benefits | | Benefits | |
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| Discount rate | 7.0% | 7.0% | 5.5% | 7.9% | 6.0% | 7.0% |
| Expected return on plan assets | 8.0% | 8.5% | 6.7% | 9.2% | | |
| Rate of compensation increase | 5.0% | 5.0% | 3.5% | 6.8% | | |
| Future profit-sharing contributions | 6.0% | 6.0% | | | | |

Asset return assumptions are derived following actuarial and statistical methodologies, from an analysis of long-term historical data relevant to the country where each plan is in effect and the investments applicable to the plan. Plans are subject to regulation under local law, which may directly or indirectly affect the types of investments that a plan may hold.

Net Periodic Benefit Cost

The net periodic benefit cost for the plans included the following components:

| (In Millions) | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | | Postretirement Medical Benefits | | |
|--------------------------------------|-----------------------|-------------|-------------|---------------------------|--------------|--------------|---------------------------------|--------------|--------------|
| | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 |
| | Service cost | \$ 7 | \$ 6 | \$ 3 | \$ 27 | \$ 22 | \$ 34 | \$ 12 | \$ 10 |
| Interest cost | 2 | 2 | 1 | 18 | 14 | 13 | 10 | 8 | 7 |
| Expected return on plan assets | (2) | (1) | (1) | (1) | (12) | (15) | | | |
| Amortization of prior service cost | 1 | | | | | 1 | 4 | 4 | 4 |
| Recognized net actuarial (gain) loss | 1 | | | 1 | | 1 | | | |
| Net periodic benefit cost | \$ 9 | \$ 7 | \$ 3 | \$ 45 | \$ 24 | \$ 34 | \$ 26 | \$ 22 | \$ 20 |

U.S. Plan Assets

The company's U.S. Pension Plan asset allocation at the end of fiscal 2003 and 2002 was 100% allocated to equity securities. The target allocation for 2004 is expected to remain the same. The expected long-term rate of return for these equity securities is 8%. The company's long-term investment goal is to provide a basic level of benefits through the U.S. Pension Plan guarantee, with an opportunity for participants to accumulate funds in excess of amounts guaranteed by the U.S. Pension Plan through asset accumulation in the Profit Sharing Plan. The U.S. plan assets are invested in equity securities, primarily in large, diversified domestic and multinational U.S. equities, which seek to match the performance of the Standard and Poor's 500 Index*. The company believes that investing in large, multinational companies achieves adequate diversity, in that such companies represent a wide range of industries, and many of those companies derive a significant portion of their revenue from non-U.S. sources or otherwise reflect market conditions throughout the world. When deemed appropriate, a portion of the fund may be invested in futures contracts for the purpose of acting as a temporary substitute for investment in equity securities. The fund does not engage in speculative futures transactions.

In order to determine the expected long-term rate of return for the U.S. plan assets, the company used actuarial and statistical methods to estimate the likely results over a 20-year time horizon. The analysis was based on historical equity market returns during the period from 1926 to 2002. Management selected a rate of return within the likely range reflecting a conservative view of future expected returns.

Funding Expectation for 2004

No further contributions are required during 2004 under applicable law for the U.S. Pension Plan. The company intends to make voluntary contributions so that assets exceed the Accumulated Benefit Obligation at the end of the year. Employer contributions to the Postretirement Medical Benefits Plan are expected to be approximately \$4 million during 2004.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 14: Business Combinations and Divestitures**

All of the company's qualifying business combinations have been accounted for using the purchase method of accounting. Consideration includes the cash paid and the value of any stock issued and options assumed, less any cash acquired, and excludes contingent employee compensation payable in cash and any debt assumed. The company accounts for the intrinsic value of stock options assumed related to future services as unearned compensation within stockholders' equity (see Note 18: Acquisition-Related Unearned Stock Compensation).

During 2003, the company completed one acquisition qualifying as a business combination in exchange for total cash consideration of approximately \$21 million. There were no acquisitions qualifying as business combinations in 2002. The acquisitions in 2001 were entered into primarily to expand Intel's optical, wired Ethernet, wireless connectivity and telecommunications capabilities. The operating results of all of the significant businesses acquired in 2003 and 2001 have been included in the results of the Intel Communications Group (ICG) operating segment from the date of acquisition.

The following table summarizes the company's business combinations completed in 2001:

| (In Millions) | Consideration | Purchased | Goodwill | Identified | Form of Consideration |
|------------------|---------------|------------------------------|----------|-------------|--|
| | | In-Process | | | |
| | | Research & Development | | Intangibles | |
| Xircom, Inc. | \$ 517 | \$ 53 | \$ 336 | \$ 154 | Cash and options assumed |
| VxTel Inc. | \$ 381 | \$ 68 | \$ 277 | \$ | Cash and options assumed |
| Cognet, Inc. | \$ 156 | \$ 9 | \$ 93 | \$ 20 | Cash, common stock and options assumed |
| LightLogic, Inc. | \$ 409 | \$ 46 | \$ 295 | \$ 9 | Common stock and options assumed |
| Other | \$ 228 | \$ 22 | \$ 153 | \$ | Cash, common stock and options assumed |

Other business combinations in the above summary represent seven business combination transactions in 2001 that were not individually significant.

Purchase consideration for acquisitions in 2001 included 21.0 million unregistered shares of Intel common stock. Of these shares, 5.2 million were contingent upon the continued employment of certain employees and/or meeting performance criteria, and approximately 4.8 million of the contingent shares have subsequently been issued. An additional 900,000 registered shares were issuable to certain employees contingent upon meeting certain performance criteria. Of these shares, approximately 700,000 were subsequently issued, and approximately 200,000 were

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forfeited, as certain milestones had not been met. For consideration payable in shares that is contingent on employment, the value is included in purchase consideration. Although included in the total consideration disclosed, the fair value of such stock compensation is allocated to unearned stock compensation (see Note 18: Acquisition-Related Unearned Stock Compensation) and is not included in the allocation of purchase price to assets acquired. For the 2001 acquisitions, \$224 million in cash compensation was contingent upon the continued employment of certain employees and/or meeting performance criteria and was not included in purchase consideration. Of this amount, approximately \$168 million was paid and approximately \$11 million was forfeited. Of the \$45 million in cash compensation remaining to be paid, approximately \$13 million was not yet earned and thus not reflected in the company's balance sheet as of December 27, 2003.

During 2003, the company recognized approximately \$758 million in tax benefits related to sales of the stock of certain previously acquired companies, primarily DSP Communications, Inc. (DSP), Dialogic Corporation and Xircom. A net benefit of approximately \$420 million was recognized during the fourth quarter of 2003 on the divestiture of a portion of the intellectual property assets of DSP, through the sale of the stock of DSP. Also during the fourth quarter of 2003, a benefit of approximately \$200 million was recognized on the divestiture of a portion of the assets, primarily real estate, of Dialogic, through the sale of the stock of Dialogic. A benefit of approximately \$125 million was recognized earlier in the year related to the sale of a wireless WAN business, through the sale of the stock of Xircom. The pre-tax losses on these sales for financial statement or book purposes were not significant. The company was able to recognize tax losses because the tax basis in the entities exceeded the book basis, as the goodwill allocated to the transactions for financial statement purposes was less than the amount the company could effectively deduct for tax purposes. During 2002, the company recognized a \$75 million tax benefit related to sales of the stock of certain previously acquired companies, primarily Ziatech Corporation.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During 2002, Intel wrote off acquisition-related identified intangibles of \$127 million, related to a portion of the developed technology acquired with the Xircom acquisition and the acquisition of Trillium Digital Systems, Inc. The impaired developed technology of Xircom primarily related to PC Ethernet cards, whose forecasted revenue declined significantly as the market moved to LAN-on-motherboard technology. The impaired developed technology of Trillium related primarily to a change in the product roadmap for telephony operating-systems software that resulted in a significant decline in forecasted revenue for that technology. The amount of the impairments was determined using a fair-value approach based on discounted future cash flows. In 2001, Intel wrote off acquisition-related identified intangibles of \$26 million and goodwill of \$98 million, related to acquisitions made prior to 2000.

For 2003, \$5 million was allocated to purchased in-process research and development (IPR&D) and expensed at the time of the acquisition (\$198 million for 2001), because the technological feasibility of products under development had not been established and no future alternative uses existed. The fair value of the IPR&D was determined using the income approach, which discounts expected future cash flows from projects under development to their net present value. Each project was analyzed to determine the technological innovations included; the utilization of core technology; the complexity, cost and time to complete development; any alternative future use or current technological feasibility; and the stage of completion. Future cash flows were estimated, taking into account the expected life cycles of the products and the underlying technology, relevant market sizes and industry trends. The company determined a discount rate for each project based on the relative risks inherent in the project's development horizon, the estimated costs of development, and the level of technological change in the project and the industry, among other factors.

Note 15: Acquisition of Development-Stage Operations

An acquisition of a development-stage operation does not qualify as a business combination under SFAS No. 141, Business Combinations, and purchase consideration for such an acquisition is not allocated to goodwill. Workforce-in-place does qualify as an identified intangible asset for an acquisition of a development-stage operation.

During 2003, the company acquired a development-stage operation in exchange for total cash consideration of approximately \$40 million, all of which was allocated to workforce-in-place. During 2002, the company acquired three development-stage operations in exchange for total consideration of approximately \$57 million, with approximately \$35 million allocated to acquisition-related developed technology and \$20 million to IPR&D, with the remaining amount representing the value of net tangible assets. The operating results of each of these acquisitions since the date of acquisition have been included in the operating results of the acquiring business unit within either the ICG operating segment or the all other category, as appropriate, for segment reporting purposes.

Note 16: Goodwill

Goodwill by operating segment was adjusted for the years ended December 28, 2002 and December 27, 2003, as follows:

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| (In Millions) | Wireless Communications and Computing | | | | Total |
|--|--|-----------------------------------|---------------|--------------|-----------------|
| | Intel Communications Group | Intel Architecture Business | Group | All Other | |
| December 29, 2001 | \$ 3,653 | \$ 68 | \$ 603 | \$ 6 | \$ 4,330 |
| Workforce-in-place reclassified, net of deferred tax | 12 | | 8 | | 20 |
| Other adjustments | (21) | 1 | | | (20) |
| December 28, 2002 | 3,644 | 69 | 611 | 6 | 4,330 |
| Impairments | | | (611) | (6) | (617) |
| Additions | 3 | | | | 3 |
| Other adjustments | (9) | (2) | | | (11) |
| December 27, 2003 | \$ 3,638 | \$ 67 | \$ | \$ | \$ 3,705 |

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the fourth quarter of 2003, the company completed its annual impairment review for goodwill and found indicators of impairment for the Wireless Communications and Computing Group (WCCG) reporting unit. The WCCG business, comprised primarily of flash memory products and cellular baseband chipsets, has not performed as management had expected. In the fourth quarter of 2003, it became apparent that WCCG was now expected to grow more slowly than previously projected. A slower-than-expected rollout of products and slower-than-expected customer acceptance of our products in the baseband chipset business, as well as a delay in the transition to next-generation phone networks, have pushed out the forecasts for sales into high-end data cell phones. These factors resulted in lower growth expectations for the reporting unit and triggered the goodwill impairment. The impairment review requires a two-step process. The first step of the review compares the fair value of the reporting units with substantial goodwill against their aggregate carrying values, including goodwill. The company estimated the fair value of the WCCG and ICG reporting units using the income method of valuation, which includes the use of estimated discounted cash flows. Based on the comparison, the carrying value of the WCCG reporting unit exceeded the fair value. Accordingly, the company performed the second step of the test, comparing the implied fair value of the WCCG reporting unit's goodwill with the carrying amount of that goodwill. Based on this assessment, the company recorded a non-cash impairment charge of \$611 million, which is included as a component of operating income in the all other category for segment reporting purposes.

Also during 2003, the goodwill related to one of the company's seed businesses, included in the all other category, was impaired. Seed businesses are businesses that support the company's strategic initiatives. In addition, goodwill in the ICG operating segment decreased, primarily as a result of goodwill allocated to divestitures on a fair value basis in 2003. During 2003, the company recorded goodwill of \$3 million in connection with a qualifying business combination. In 2002, no goodwill was recorded or impaired.

Upon adoption of SFAS No. 141, workforce-in-place no longer meets the definition of an identifiable intangible asset in acquisitions qualifying as business combinations. As a result, as of the beginning of 2002, the net book value of the company's workforce-in-place of \$39 million, along with associated deferred tax liabilities of \$19 million, was reclassified to goodwill (see Goodwill under Note 2: Accounting Policies).

Note 17: Identified Intangible Assets

Identified intangible assets acquired during 2003 and 2002 are summarized as follows:

| (In Millions) | 2003 | | 2002 | |
|---|---------------|-----------------------|---------------|-----------------------|
| | Value | Weighted Average Life | Value | Weighted Average Life |
| Acquisition-related developed technology | \$ 14 | 4 | \$ 35 | 2 |
| Other acquisition-related intangibles | 40 | 2 | | |
| Intellectual property assets | 96 | 5 | 317 | 7 |
| Total identified intangible assets | \$ 150 | | \$ 352 | |

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Of the intellectual property assets acquired in 2002, \$295 million represented the value of assets capitalized as a result of payments under the settlement agreement with Intergraph Corporation related to the lawsuits in Alabama and Texas (see Note 21: Contingencies). The value of the Intergraph assets and the amount of the charge to cost of sales in 2002 were derived from the historical and expected future revenue from sales of the relevant microprocessors.

Identified intangible assets as of December 27, 2003 consisted of the following:

| <u>(In Millions)</u> | <u>Gross</u> <u>Assets</u> | <u>Accumulated</u> <u>Amortization</u> | <u>Net</u> |
|---|-------------------------------|---|---------------|
| Acquisition-related developed technology | \$ 994 | \$ (772) | \$ 222 |
| Other acquisition-related intangibles | 94 | (49) | 45 |
| Intellectual property assets | 604 | (212) | 392 |
| Total identified intangible assets | \$ 1,692 | \$ (1,033) | \$ 659 |

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Identified intangible assets as of December 28, 2002 consisted of the following:

| (In Millions) | Gross | Accumulated | Net |
|---|-----------------|-------------------|---------------|
| | Assets | Amortization | |
| Acquisition-related developed technology | \$ 1,125 | \$ (727) | \$ 398 |
| Other acquisition-related intangibles | 74 | (52) | 22 |
| Intellectual property assets | 750 | (336) | 414 |
| Total identified intangible assets | \$ 1,949 | \$ (1,115) | \$ 834 |

Amortization of acquisition-related intangibles and costs included the following:

| (In Millions) | 2003 | 2002 | 2001 |
|---|---------------|---------------|---------------|
| Amortization of acquisition-related intangibles | \$ 203 | \$ 246 | \$ 347 |
| Impairment of acquisition-related intangibles | | 127 | 26 |
| Amortization of acquisition-related unearned stock compensation | 39 | 90 | 174 |
| Other acquisition-related costs | 59 | 85 | 81 |
| Total | \$ 301 | \$ 548 | \$ 628 |

Acquisition-related intangible impairments of \$127 million in 2002 represented write-offs of developed technology and other acquisition-related intangibles primarily related to the previous acquisitions of Xircom and Trillium (see Note 14: Business Combinations and Divestitures). Other acquisition-related costs include the amortization of deferred cash payments that represent contingent compensation to employees related to previous acquisitions. The compensation is being recognized over the period earned. All amortization of acquisition-related intangibles and costs, including impairments, is included in all other for segment reporting purposes.

Amortization of intellectual property assets was \$118 million in 2003 (\$120 million in 2002 and \$89 million in 2001). The amortization of an intellectual property asset is generally included in either cost of sales or research and development.

Based on the carrying value of identified intangible assets recorded at December 27, 2003, and assuming no subsequent impairment of the underlying assets, the annual amortization expense, excluding acquisition-related stock compensation and other acquisition-related costs, is expected to be as follows:

| <u>(In Millions)</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|
| Acquisition-related intangibles | \$ 143 | \$ 102 | \$ 21 | \$ 1 | \$ |
| Intellectual property assets | \$ 104 | \$ 86 | \$ 73 | \$ 41 | \$ 32 |

Note 18: Acquisition-Related Unearned Stock Compensation

The company records acquisition-related purchase consideration as unearned stock-based compensation in accordance with FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation. During 2003 and 2002, the company recorded no such unearned stock-based compensation. Acquisition-related unearned stock compensation includes the portion of the purchase consideration related to shares issued contingent upon the continued employment of selected employee stockholders and/or the completion of specified milestones. The unearned stock-based compensation also includes the intrinsic value of stock options assumed in connection with business combinations that is earned as the employees provide future services. The compensation is being recognized over the period earned, and the expense is included in the amortization of acquisition-related intangibles and costs. Amortization of unearned stock compensation was \$39 million for 2003 (\$90 million for 2002 and \$174 million for 2001). For 2003, unearned stock compensation in the statement of stockholders' equity was reduced by \$4 million related to various adjustments (\$12 million in 2002) and in 2002 was additionally reduced by \$13 million related to net losses on sales of businesses that were included in operating income.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 19: Impairment of Long-Lived Assets

During 2003, the company had substantially completed the wind-down of its Intel® Online Services web hosting business. The company has recognized a related \$131 million pre-tax charge in cost of sales, of which \$106 million was recorded in 2002, and the remainder was recorded in the first half of 2003 due to an increase in the estimate of assets that will no longer be utilized. Approximately \$123 million of the charge related to the impairment of the web hosting business' assets, including leasehold improvements and server equipment. The amount of the impairment was determined based on discounted future cash flows and comparable market prices. The remaining \$8 million represented the accrual of lease and other exit-related costs. The total charge was reflected in the 'all other' category for segment reporting purposes. For both 2003 and 2002, the operating results of this business were not significant to the results of the company.

Note 20: Commitments

The company leases a portion of its capital equipment and certain of its facilities under operating leases that expire at various dates through 2026. Rental expense was \$149 million in 2003, \$163 million in 2002 and \$182 million in 2001. Minimum rental commitments under all non-cancelable leases with an initial term in excess of one year are payable as follows: 2004 \$101 million; 2005 \$83 million; 2006 \$52 million; 2007 \$35 million; 2008 \$29 million; 2009 and beyond \$203 million. Commitments for construction or purchase of property, plant and equipment approximated \$1.5 billion at December 27, 2003. Other commitments as of December 27, 2003 totaled \$317 million. Other commitments included payments due under various types of licenses, and non-contingent joint funding obligations, such as co-marketing and co-development initiatives.

Note 21: Contingencies

Tax Matters

In August 2003, in connection with the IRS's regular examination of Intel's tax returns for the years 1999 and 2000, the IRS proposed certain adjustments to the amounts reflected by Intel on these returns as a tax benefit for its export sales. If the IRS issues formal assessments consistent with the notices and ultimately prevails in its position, Intel's federal income tax due for these years would increase by approximately \$600 million, plus interest. The IRS may make similar claims for years subsequent to 2000 in future audits.

Intel disputes the proposed adjustments and intends to pursue this matter through applicable IRS and judicial procedures, as appropriate. Although the final resolution of the proposed adjustments is uncertain, based on currently available information, management believes that the ultimate outcome will not have a material adverse effect on the company's financial position, cash flows or overall trends in results of operations. In the event of an unfavorable resolution, there exists the possibility of a material adverse impact on the results of operations of the period in which the matter is ultimately resolved, or an unfavorable outcome becomes probable and reasonably estimable.

Legal Proceedings

In 1997, Intergraph Corporation filed suit in Federal District Court in Alabama, generally alleging, among other claims, that Intel infringed certain Intergraph patents. In August 2001, Intergraph filed a second suit in the U.S. District Court for the Eastern District of Texas, alleging that the Intel® Itanium® processor infringes two Intergraph microprocessor-related patents, and seeking an injunction and unspecified damages. In April 2002, Intel and Intergraph announced that they entered into a settlement agreement, pursuant to which they agreed to settle the Alabama lawsuit and dismiss it with prejudice. Pursuant to the settlement agreement, Intel made a cash payment of \$300 million to Intergraph and in return received a license under all Intergraph patents, excluding the patents at issue in the Texas case. Intel recorded \$155 million of the payment as a charge in 2002. The remaining \$145 million represented the value of the license received and was capitalized as an intangible asset (see Note 17: Identified Intangible Assets).

Under the settlement agreement, the Texas case would proceed to trial. If the patents in the Texas case were found to be infringed, not invalid and enforceable, Intel would pay Intergraph \$150 million within 30 days of the entry of a final judgment. If Intergraph prevailed on either patent on appeal, the settlement agreement provides that Intel would pay Intergraph an additional \$100 million and would receive a license for the patents at issue in the case.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In October 2002, the Texas District Court ruled that Intel infringed both patents at issue in that case. Pursuant to the settlement agreement, Intel paid Intergraph \$150 million. Intel then appealed the trial court's decision. In February 2004, the Court of Appeals for the Federal Circuit found that the District Court erred in construing a claim term, revised the claim construction, vacated the District Court ruling and remanded the case to the District Court to determine in the first instance whether the Intel Itanium processor infringes the patents. Intel is currently evaluating the impact that the Court of Appeals' opinion has on the 2002 settlement agreement.

In December 2002, Intergraph filed suit in the Eastern District of Texas against Dell Inc., Gateway Inc. and Hewlett-Packard Company, alleging infringement of three of Intergraph's patents. These three patents are a subset of the patents that were the subject of a now settled lawsuit that Intergraph had filed against Intel in Alabama. In May 2003, Dell filed its answer and counterclaim and named Intel as well as Intergraph in a counterclaim for declaratory judgment. None of the other defendants have named Intel as a counter-defendant. The claim against Intel does not seek any monetary or other specific relief. Rather, Dell seeks a judicial interpretation of the April 2002 settlement and license agreement between Intel and Intergraph insofar as that agreement relates to any express and implied licenses and patent exhaustion defenses Dell has raised to defend the Intergraph claims. Dell has also issued a request for indemnity from Intel for any damages awarded against Dell, although this issue has not been made an element of the pending litigation. Intel intends to participate vigorously in the defense of all relevant claims.

In May 2000, various plaintiffs filed a class-action lawsuit in the U.S. District Court for the Northern District of California, alleging violations of the Securities Exchange Act of 1934 (Exchange Act) and Rule 14d-10 of the Exchange Act in connection with Intel's acquisition of DSP Communications, Inc. The complaint alleged that Intel and CWC (Intel's wholly owned subsidiary at the time) agreed to pay certain DSP executives additional consideration of \$15.6 million not offered or paid to other stockholders. The alleged purpose of this payment to the insiders was to obtain DSP insiders' endorsement of Intel's tender offer in violation of the anti-discrimination provision of Section 14(d)(7) and Rule 14d-10. The plaintiffs sought unspecified damages for the class, and unspecified costs and expenses. In July 2002, the District Court granted Intel's motion for summary judgment, but in October 2002, the District Court vacated the summary judgment. In January 2003, the parties reached a settlement agreement, which was reviewed and approved by the court in June 2003. The settlement did not have a material impact on the company's results of operations or financial condition.

In September 2001, VIA Technologies, Inc. and Centaur Technology, Inc. sued Intel in the U.S. District Court for the Western District of Texas, alleging that the Intel® Pentium® 4 processor infringes a VIA microprocessor-related patent. In October 2001, Intel filed counterclaims against VIA, asserting that VIA's C3* microprocessors infringe Intel patents. In January 2002, VIA amended its complaint to allege that Intel's Pentium® II, Pentium® III, Celeron® and Pentium 4 processors infringe another patent. In August 2002, Intel added an additional claim that VIA's C3 microprocessors infringe an additional Intel patent, and VIA added an additional claim that Intel's Pentium® III and Pentium 4 processors infringe another VIA patent. In April 2003, the parties entered into a settlement agreement, pursuant to which they agreed to dismiss with prejudice the claims and counterclaims in this lawsuit, and to dismiss all other pending legal claims between them in all jurisdictions. The confidential settlement agreement includes a patent cross-license agreement covering certain of each company's products, subject to certain terms and limitations. The settlement agreement did not have a material impact on the company's results of operations or financial condition.

In 2001, various plaintiffs filed five class-action lawsuits against Intel alleging violations of the Securities Exchange Act of 1934. These complaints were consolidated in an amended complaint filed in the U.S. District Court for the Northern District of California. The lawsuit alleged that purchasers of Intel stock between July 19, 2000 and September 29, 2000 were misled by false and misleading statements by Intel and certain of its officers and directors concerning the company's business and financial condition. In July 2003, the court granted Intel's motion to dismiss the plaintiffs' second amended complaint in its entirety with prejudice, and the plaintiffs did not appeal the court's dismissal of the suit.

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In addition, various plaintiffs filed stockholder derivative complaints in California Superior Court and Delaware Chancery Court against the company's directors and certain officers, alleging that they mismanaged the company and otherwise breached their fiduciary obligations to the company. The plaintiffs in the California action filed the original and two successive amended complaints, and the California Superior Court sustained Intel's demurrers on each of these complaints. Following the court's dismissal without prejudice of these complaints, the plaintiffs notified the court and Intel in June 2003 that they would not file a fourth complaint, and they signed a stipulation withdrawing their lawsuit with prejudice, which the court approved. In December 2003, the plaintiffs in the Delaware action withdrew their complaint, and the case was dismissed with prejudice.

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INTEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In June 2002, various plaintiffs filed a lawsuit in the Third Judicial Circuit Court, Madison County, Illinois, against Intel, Hewlett-Packard Company, HPDirect, Inc. and Gateway Inc., alleging that the defendants' advertisements and statements misled the public by suppressing and concealing the alleged material fact that systems that use the Intel Pentium 4 processor are less powerful and slower than systems using the Intel Pentium III processor and a competitor's processors. The plaintiffs claim that their lawsuit should be treated as a nationwide class action. The plaintiffs seek unspecified damages, and attorneys' fees and costs. The company disputes the plaintiffs' claims and intends to defend the lawsuit vigorously.

The company is currently a party to various claims and legal proceedings, including those noted above. If management believes that a loss arising from these matters is probable and can reasonably be estimated, the company records the amount of the loss, or the minimum estimated liability when the loss is estimated using a range, and no point within the range is more probable than another. As additional information becomes available, any potential liability related to these matters is assessed and the estimates are revised, if necessary. Based on currently available information, management believes that the ultimate outcome of these matters, 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. However, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. An unfavorable ruling could include monetary damages or an injunction prohibiting Intel from selling one or more products. If an unfavorable ruling were to occur, there exists the possibility of a material adverse impact on the results of operations of the period in which the ruling occurs, or future periods.

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, 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 and environmental proceedings could change in the future.

Note 22: Operating Segment and Geographic Information

The company designs, develops, manufactures and markets computing and communications products at various levels of integration. The company currently reports three product-line operating segments: the Intel Architecture business, which is composed of the Desktop Platforms Group, the Mobile Platforms Group and the Enterprise Platforms Group; the Intel Communications Group (ICG); and the Wireless Communications and Computing Group (WCCG). In December 2003, the company announced that it would be consolidating communications-related businesses within ICG and WCCG. This reorganization was not effective until fiscal 2004. Because this reporting period is as of December 27, 2003, the operating segment results for these communications-related businesses are presented under the organizational structure that existed as of December 27, 2003.

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The company's Executive Office consists of Chief Executive Officer (CEO) Craig R. Barrett and President and Chief Operating Officer (COO) Paul S. Otellini. The CEO and COO have joint responsibility as the Chief Operating Decision Maker (CODM), as defined by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. The CODM allocates resources to and assesses the performance of each operating segment using information about their revenue and operating profit before interest and taxes.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Intel Architecture operating segment's products include microprocessors and related chipsets and motherboards. Net revenue for the Intel Architecture operating segment made up approximately 87% of the company's consolidated net revenue in 2003 (83% in 2002 and 81% in 2001). Revenue from sales of microprocessors within the Intel Architecture operating segment represented 73% of consolidated net revenue in 2003 (70% in 2002 and 67% in 2001). ICG's products include wired Ethernet and wireless connectivity products, network processing components and embedded computing products. WCCG's products include flash memory, application processors, and cellular baseband chipsets for cellular handsets and handheld devices. The company's products in all operating segments are sold directly to original equipment manufacturers, and through retail and industrial distributors as well as reseller channels throughout the world.

In addition to these operating segments, the company has sales and marketing, manufacturing, finance and administration groups. Expenses of these groups are allocated to the operating segments and are included in the operating results reported below.

The all other category includes acquisition-related costs, including amortization of acquisition-related intangibles and charges for purchased in-process research and development. In 2003, acquisition-related costs also included a goodwill impairment charge of \$611 million taken in the fourth quarter for the remaining goodwill balance related to WCCG, and in 2002 included a \$127 million impairment of acquisition-related identified intangibles related to prior-year acquisitions. All other also includes the results of operations of seed businesses that support the company's initiatives, and the results for 2002 included a charge of \$106 million related to the wind-down of the Intel Online Services web hosting business. Finally, all other includes certain corporate-level operating expenses, including a portion of profit-dependent bonus and other expenses not allocated to the operating segments. For 2001, all other also included goodwill amortization; however, beginning in 2002, goodwill is no longer amortized.

The company does not identify or allocate assets by operating segment, and does not allocate depreciation as such to the operating segments, nor does the CODM evaluate operating segments on these criteria. Operating segments do not record intersegment revenue, and, accordingly, there is none to be reported. The company does not allocate interest and other income, interest expense or taxes to operating segments. Except as discussed above, the accounting policies for segment reporting are the same as for the company as a whole.

Net revenue and operating income or loss for reportable segments for the three years ended December 27, 2003 were as follows:

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|-------------|-------------|-------------|
| Intel Architecture Business | | | |
| Net revenue | \$ 26,102 | \$ 22,316 | \$ 21,446 |
| Operating income | \$ 10,411 | \$ 6,592 | \$ 6,277 |
| Intel Communications Group | | | |
| Net revenue | \$ 2,147 | \$ 2,080 | \$ 2,580 |
| Operating loss | \$ (426) | \$ (622) | \$ (735) |
| Wireless Communications and Computing Group | | | |
| Net revenue | \$ 1,857 | \$ 2,239 | \$ 2,232 |
| Operating loss | \$ (432) | \$ (287) | \$ (249) |
| All Other | | | |

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| | | | |
|------------------|------------|------------|------------|
| Net revenue | \$ 35 | \$ 129 | \$ 281 |
| Operating loss | \$ (2,020) | \$ (1,301) | \$ (3,037) |
| Total | | | |
| Net revenue | \$ 30,141 | \$ 26,764 | \$ 26,539 |
| Operating income | \$ 7,533 | \$ 4,382 | \$ 2,256 |

In 2003, one customer accounted for approximately 19% of the company's revenue (16% in 2002) while another customer accounted for approximately 15% in both 2003 and 2002. These customers each accounted for approximately 14% of the company's revenue in 2001. A substantial majority of the sales to these customers were Intel Architecture business products.

Geographic revenue information for the three years ended December 27, 2003 is based on the location of the customer. Property, plant and equipment information is based on the physical location of the assets at the end of each of the fiscal years.

Table of Contents**INTEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Revenue from unaffiliated customers by geographic region/country was as follows:

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|----------------------|-------------------------|-------------------------|-------------------------|
| United States | \$ 7,644 | \$ 7,698 | \$ 8,233 |
| Other Americas | 759 | 950 | 1,149 |
| | <u>8,403</u> | <u>8,648</u> | <u>9,382</u> |
| Taiwan | 4,405 | 2,854 | 2,531 |
| China | 3,679 | 3,199 | 2,333 |
| Other Asia-Pacific | 4,077 | 4,020 | 3,444 |
| | <u>12,161</u> | <u>10,073</u> | <u>8,308</u> |
| Europe | 6,868 | 6,139 | 6,500 |
| Japan | 2,709 | 1,904 | 2,349 |
| | <u>9,577</u> | <u>8,043</u> | <u>8,849</u> |
| Total revenue | <u>\$ 30,141</u> | <u>\$ 26,764</u> | <u>\$ 26,539</u> |

Revenue from unaffiliated customers outside the U.S. totaled \$22,497 million (\$19,066 million in 2002 and \$18,306 million in 2001).

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

| <u>(In Millions)</u> | <u>2003</u> | <u>2002</u> |
|---|-------------------------|-------------------------|
| United States | \$ 12,483 | \$ 14,518 |
| Ireland | 2,392 | 1,405 |
| Other countries | 1,786 | 1,924 |
| | <u>16,661</u> | <u>17,847</u> |
| Total property, plant and equipment, net | <u>\$ 16,661</u> | <u>\$ 17,847</u> |

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REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders, Intel Corporation

We have audited the accompanying consolidated balance sheets of Intel Corporation as of December 27, 2003 and December 28, 2002, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 27, 2003. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Intel Corporation at December 27, 2003 and December 28, 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 27, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, effective December 30, 2001, the company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

/s/ Ernst & Young LLP

San Jose, California

January 13, 2004

Table of Contents**INTEL CORPORATION****FINANCIAL INFORMATION BY QUARTER (UNAUDITED)**

(In Millions Except Per Share Amounts)

| 2003 For Quarter Ended | December 27 | September 27 | June 28 | March 29 |
|---|--------------------|---------------------|----------------|-----------------|
| Net revenue | \$ 8,741 | \$ 7,833 | \$ 6,816 | \$ 6,751 |
| Gross margin | \$ 5,556 | \$ 4,558 | \$ 3,468 | \$ 3,512 |
| Impairment of goodwill | \$ 611 | \$ | \$ 6 | \$ |
| Amortization of acquisition-related intangibles and costs | \$ 65 | \$ 68 | \$ 84 | \$ 84 |
| Purchased in-process research and development | \$ | \$ 5 | \$ | \$ |
| Net income ¹ | \$ 2,173 | \$ 1,657 | \$ 896 | \$ 915 |
| Basic earnings per share ¹ | \$ 0.33 | \$ 0.25 | \$ 0.14 | \$ 0.14 |
| Diluted earnings per share ¹ | \$ 0.33 | \$ 0.25 | \$ 0.14 | \$ 0.14 |
| Dividends per share | | | | |
| Declared | \$ | \$ 0.04 | \$ | \$ 0.04 |
| Paid | \$ 0.02 | \$ 0.02 | \$ 0.02 | \$ 0.02 |
| Market price range common stock ² | | | | |
| High | \$ 34.12 | \$ 29.18 | \$ 22.14 | \$ 18.90 |
| Low | \$ 27.52 | \$ 20.81 | \$ 16.28 | \$ 15.05 |

(In Millions Except Per Share Amounts)

| 2002 For Quarter Ended | December 28 | September 28 | June 29 | March 30 |
|--|--------------------|---------------------|----------------|-----------------|
| Net revenue | \$ 7,160 | \$ 6,504 | \$ 6,319 | \$ 6,781 |
| Gross margin | \$ 3,696 | \$ 3,173 | \$ 2,969 | \$ 3,480 |
| Amortization and impairment of acquisition-related intangibles and costs | \$ 106 | \$ 102 | \$ 229 | \$ 111 |
| Purchased in-process research and development | \$ | \$ 6 | \$ 14 | \$ |
| Net income | \$ 1,049 | \$ 686 | \$ 446 | \$ 936 |
| Basic earnings per share | \$ 0.16 | \$ 0.10 | \$ 0.07 | \$ 0.14 |
| Diluted earnings per share | \$ 0.16 | \$ 0.10 | \$ 0.07 | \$ 0.14 |
| Dividends per share | | | | |
| Declared | \$ | \$ 0.04 | \$ | \$ 0.04 |
| Paid | \$ 0.02 | \$ 0.02 | \$ 0.02 | \$ 0.02 |
| Market price range common stock ² | | | | |
| High | \$ 21.05 | \$ 19.59 | \$ 31.20 | \$ 35.79 |
| Low | \$ 13.22 | \$ 14.13 | \$ 18.27 | \$ 28.55 |

¹ Net income for the quarter ended December 27, 2003 included \$620 million in tax benefits related to divestitures, increasing both basic and diluted earnings per share by \$0.09.

² 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 common stock also trades on The Swiss Exchange. At December 27, 2003, there were approximately 236,000 registered holders of common stock. All stock prices are closing prices per The NASDAQ Stock Market.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

The following exhibits are filed herewith:

- 23.1 Consent of Ernst & Young LLP, Independent Auditors.
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
- 31.2 Certification of Chief Financial Officer and Principal Accounting Officer Pursuant to Rule 13a-14(a) of the Exchange Act.
- 32.1 Certification of the Chief Executive Officer and Chief Financial Officer and Principal Accounting Officer Pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INTEL CORPORATION

Registrant

Date: February 23, 2004

By: /s/ ANDY D. BRYANT

Andy D. Bryant

Executive Vice President, Chief Financial Officer
and Principal Accounting Officer