

Intel

Initiating With Outperform (1)

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Analysts

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One High-Quality Turnaround Story

Conclusion: We are initiating coverage of INTC with an Outperform rating and believe that the shares can appreciate by 10-30% relative to the market over the next 12 months. We expect the company's pending, massive product refresh to curb market share losses and that ongoing organizational changes will improve focus on the core PC businesses. We believe the new streamlined organization will be able to avoid a reoccurrence of recent multiple execution missteps. In addition, we expect INTC's manufacturing lead and ability to offer complete platform solutions to result in competitive advantages. We expect the stock price to appreciate as investors begin to see evidence of this turnaround.

- **New Products Should Reverse Market Share Losses.** New products for notebooks, desktops, and servers address deficiencies in power consumption, and 64-bit support should help the company stem recent market share losses.
- **Manufacturing is a Key Competitive Advantage.** At the 65nm node, Intel is at least nine months ahead of its comps. This advantage not only helps address competitive parameters such as power and speed, but also better equips INTC to drive competitive pricing w/ muted impact on margins.
- **Streamlining Should Increase Competitiveness.** We believe Intel's recent moves to optimize organizational structure and divest unrelated businesses will significantly increase the company's competitiveness and execution in the core PC-related businesses.
- **Stock Appears Attractively Valued.** The stock is trading at 16.1x our CY07 EPS estimate, and we believe this multiple can expand to 18-21x as investors become more confident that the company can reverse recent market share trends.

INTC (08/15)		\$18.00	Revenue \$MM								
Mkt cap		\$105.6B	FY	2005		2006E		2007E		2008E	
Dil shares out		5868.0MM	Dec	Actual	Prior	Current	Prior	Current	Prior	Current	
Avg daily vol		64,696.3K	Q1	9,434.0	—	8,940.0A	—	9,012.0	—	—	
52-wk range		\$16.8-27.5	Q2	9,231.0	—	8,009.0A	—	8,922.0	—	—	
Dividend		\$0.40	Q3	9,960.0	—	8,506.0	—	9,770.0	—	—	
Dividend yield		2.2%	Q4	10,201.0	—	9,339.0	—	10,942.0	—	—	
BV/sh		\$5.93	Year	38,826.0	—	34,794.0	—	38,646.0	—	—	
Net cash/sh		\$0.90	EV/S	—	—	2.8x	—	2.5x	—	—	
Debt/cap		6.3%									
ROA (LTM)		7.7%									
5-yr fwd EPS growth (Norm)		NA									
S&P 500		1280.5	EPS ⁽¹⁾ \$								
			FY	2005		2006E		2007E		2008E	
			Dec	Actual	Prior	Current	Prior	Current	Prior	Current	
			Q1	0.35	—	0.23A	—	0.23	—	—	
			Q2	0.33	—	0.15A	—	0.22	—	—	
			Q3	0.32	—	0.17	—	0.28	—	—	
			Q4	0.40	—	0.24	—	0.37	—	—	
			Year	1.40	—	0.79	—	1.09	—	—	
			P/E	—	—	22.8x	—	16.5x	—	—	

⁽¹⁾Pro forma EPS excludes equity-based compensation

Investment Thesis

We believe that INTC represents an uncharacteristically high-quality “turnaround” play and advocate buying the stock now to participate in the expected share appreciation driven by the pending turnaround. The company’s recent market share losses to AMD (\$20.69, Neutral) and lack of performance leadership have persisted well beyond all historical norms. As a result, the stock price has declined by 35% from its recent high of \$27.50 in November 2005. We believe the stock is priced to reflect investors’ “show me” attitude regarding Intel’s ability to regain market share.

We acknowledge that Intel faces a significant challenge. AMD is a much more significant competitor than in any previous period, and regaining market share will be more difficult than at any time in the past. We believe AMD’s brand will have greater staying power as a result of its recent support/endorsements throughout the PC ecosystem (e.g., Microsoft’s operating system support, Dell’s first-ever use of AMD processors). However, we believe that Intel’s pending, massive product refresh is, at minimum, capable of stabilizing its market share. We also believe that the company’s manufacturing leadership and ability to leverage broader platform offerings makes Intel better equipped to compete than AMD. Finally, we anticipate better execution and renewed vigor resulting from the company’s willingness to streamline product offerings and the organizational structure to focus on its core competency of PC processors and supporting chips.

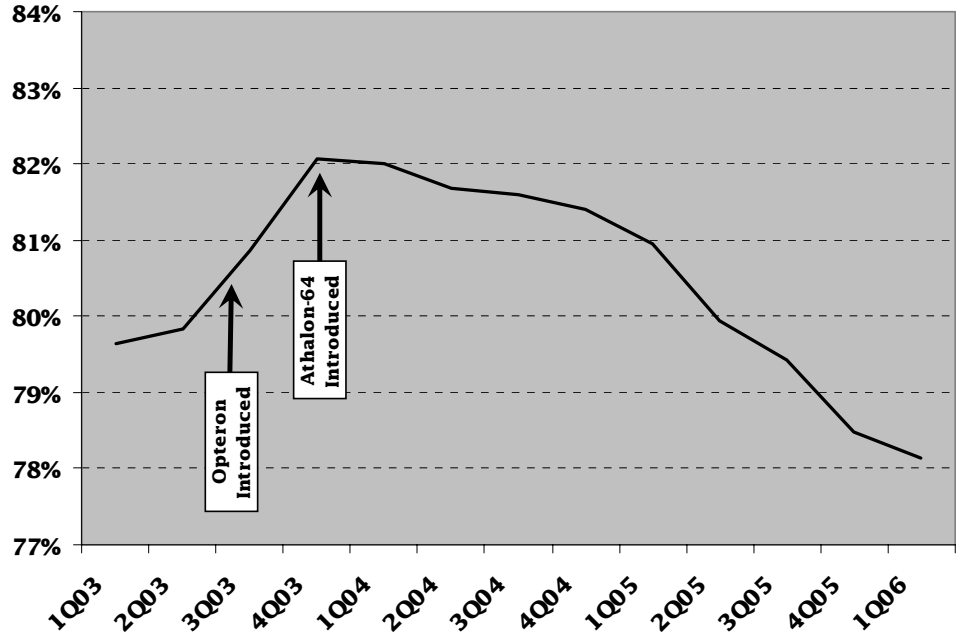
We believe that Intel is within two quarters of delivering the market share transition and financial performance that will address investors’ “show me” view on the stock. As investors see proof of a turnaround, we expect the stock to return to more normal market valuations as defined by the company’s historical and the industry’s current averages. As a result, we believe that the stock represent a compelling investment opportunity.

Investment Highlights

Massive Product Refresh Imminent

We expect Intel’s extensive new product introductions over the next six to nine months to be the most significant series of events within the PC arena over this period. With major processor upgrades for virtually all platforms from notebooks to servers, we expect Intel to have closed and in many instances reversed the performance gap with AMD. As a result of this reinvigorated product offering, we expect Intel to, at a minimum, halt market share losses. Figure 1 outlines Intel’s market share losses, which began in late 2003 as a result of AMD’s Opteron and Athalon-64 product introductions.

Figure 1: Intel's Market Share (by units)



Source: Cowen and Company

The primary competitive elements of a processor road map today include: (1) power consumption, (2) 64-bit capability, (3) multiple core architectures and (4) manufacturing process technology. Intel's market share loss over the last 12 months was driven first and foremost by AMD's superior power consumption and, to a lesser degree, AMD's broad support of 64-bit instructions. We acknowledge that AMD's winning strategy of developing a backward compatible 64-bit architecture was both insightful and highly visible. However, we believe this differentiation was only an advantage in the server/workstation segments since we do not believe that 64-bit support will be important to users in the mobile and desktop market until Microsoft releases the Vista operating system in early 2007. With respect to the last two attributes, multi-core technology is best viewed as a design approach to achieve power savings, and manufacturing process technology is best viewed as a way to achieve power savings, performance, and improved costs. We outline below the major pending developments in Intel's road map by platform. On July 27, 2006, Intel began shipping processors into every platform type. These processors are multi-core, support industry-standard 64-bit instructions, are manufactured on an industry-leading 65 nanometer process, and offer significant power savings. Figure 2 outlines these product introductions.

Mobile

Intel's mobile offering was the first to get a significant product refresh as the company attempted to maintain its product leadership. In January 2006, the company introduced the processor previously code named Yonah. The most significant aspect of this introduction was that it marked the company's and the industry's first PC processor manufactured on a 65 nanometer process. Architecturally, the processor was not that significant since it borrowed the same micro architecture that was used in the processors marketed under the "Pentium M" brand (code names Baniyas and Dothan). The Yonah processor is marketed under the

brand names Core Duo for the dual core version and Core Solo for the single core version (single core version is identical to the dual core die with one core disabled). The Core Duo enjoys the distinction of being the industry's first sub 25-watt dual core processor. Neither the Core Duo nor Core Solo support 64-bit instructions as a result of their "re-used" micro architecture.

On July 27 2006, the mobile offering enjoyed yet another refresh with the introduction of the processor code named Merom. Merom is marketed under the Core Duo brand. Similar to the previous generation, Merom is marketed in both a double core (designated Duo) and a single core (Designated Solo). The Merom processor is manufactured on the 65 nanometer process and is the first Intel mobile processor to support 64-bit instructions. Merom shares the same micro architecture as the processors targeted at the server/workstations and desktop markets (code names Woodcrest and Conroe). The Merom processor has a 20% increase in performance at roughly the same power consumption as its predecessor, the Yonah-based Core Duo. We expect the Merom processor to account for greater than 35% of all Intel mobile processor shipments and greater than 50% of all Intel mobile processors shipments for the performance segment by the end of 2006. Continued refresh is anticipated with Merom processors supporting faster bus speeds expected in the early 2007 timeframe.

Desktop

Intel's desktop processor was also significantly upgraded on July 27 2006. It is at this point that Intel abandoned the NetBurst Micro architecture that had been the basis of all non-mobile processors since 2000. The new micro architecture, known as Intel Core Micro, is the eighth-generation architecture developed by Intel for the x 86 microprocessor legacy. This micro architecture, while completely new, has its roots in the design approach utilized by the highly successful family of processors within the Centrino platform. The first desktop variant of this family that was introduced at the end of July was originally code named Conroe and will be marketed under the "Core 2 Duo" label. Conroe is manufactured on the company's 65 nanometer process, is based on the Intel Core Micro architecture, has two cores, and supports 64-bit instructions. The processor is expected to provide a 40% performance increase while at the same time decrease power consumption by 40% compared to its predecessor, the Pentium D. The processor also supports new technology to defend against malicious software attacks, (LaGrande Technology), Enhanced SpeedStep Technology for power savings, and technology to allow remote management of PCs (iAMT2) in an effort to simplify and reduce the costs of managing corporate PCs.

Server/Workstation

The server market is where AMD struck the hardest in 2005, gaining almost ten percentage points of market share in this high-margin portion of the business. The majority of AMD's gains were driven by superior power efficiency combined with support for 64-bit instructions. Before June 2006, Intel's response to these competitive issues was somewhat mutually exclusive. In 2004, Intel acknowledged the need for industry-standard 64-bit instruction support by introducing the processor code named "Nocona." While this processor did support 64-bit instructions, it came up short on the performance and power attributes when compared to AMD's Opteron processor offering. Then in March 2006, Intel introduced a processor code named Sossaman, its response to the power efficiency issue. Sossaman was a variation of the Yonah processor originally targeted at the mobile market. Like Yonah, Sossaman lacked support for 64-bit instructions and as

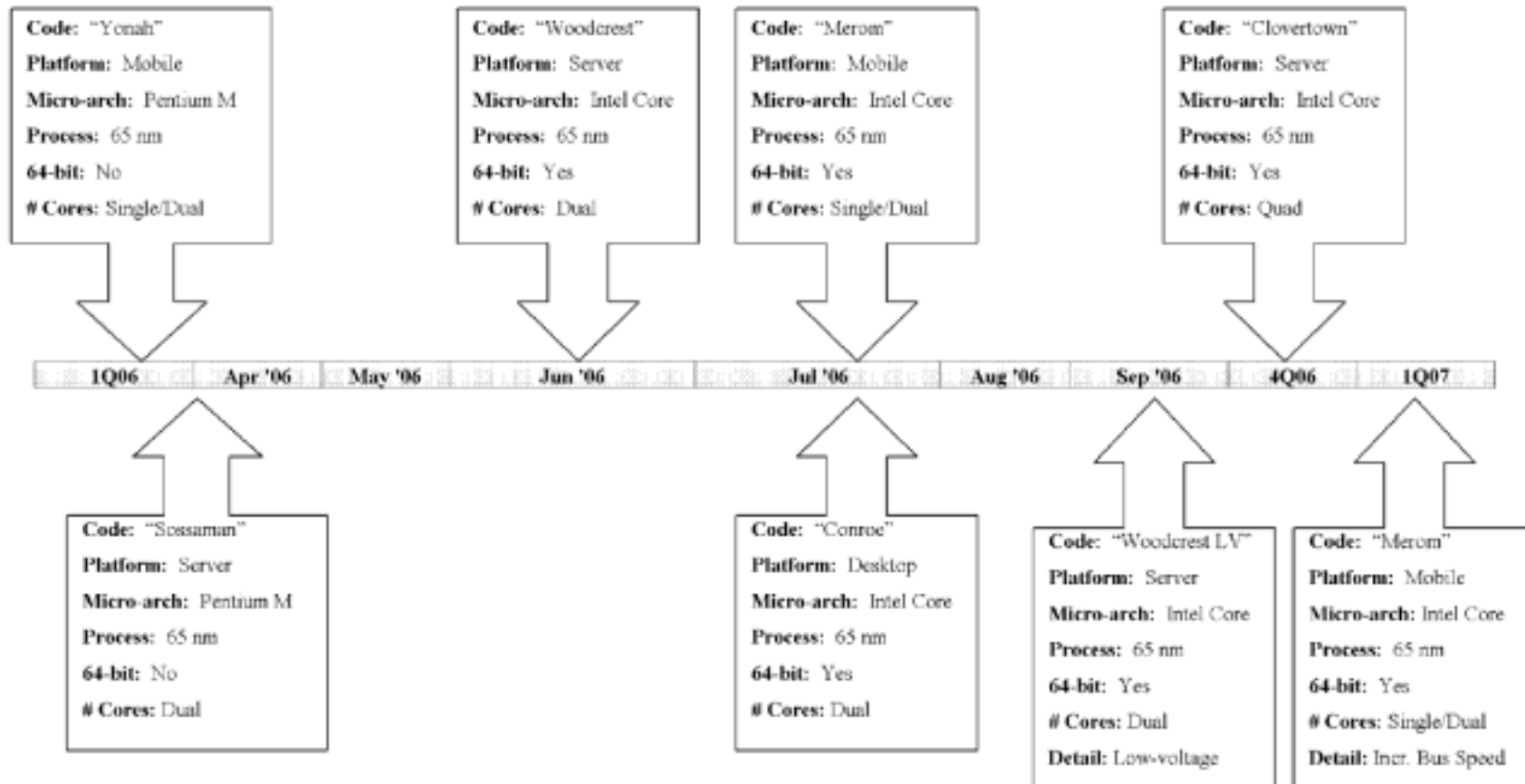
such, we believe this product introduction was intended to be a stop gap until the real contender, Woodcrest, could be launched.

Intel introduced Woodcrest on June 26, 2006. Woodcrest represents the first product introduction based on Intel's new micro architecture commonly referred to as "Intel Core Architecture" and is the same architecture to be marketed under the "Core Duo" label in the desktop and notebook markets. However, in the server market there will be no such change to the marketing name, with Intel continuing to leverage the Xeon brand. Woodcrest is manufactured on Intel's 65 nanometer process, has two cores, and supports 64-bit instructions. The processor boasts a 135% performance increase while at the same time decreased power consumption by 40% compared to its predecessor the Pentium D. This product introduction is expected to be followed with a low voltage (LV) version of Woodcrest to address ultra dense servers in the third quarter of 2006 and then a quad-core version code named "Clovertown" (two dual-core die in one multi-chip module) in the first quarter of 2007.

The Woodcrest launch may also have marked a potential turning point as it pertains to Intel's recently tarnished reputation for new product execution. The bottom line is that the Woodcrest launch came in ahead of schedule and with improved power specifications. Woodcrest was originally scheduled for a third quarter 2006 launch with all speed variants targeted at an 80 watt thermal design point (TDP). In actuality, the processor was launched in the second quarter and after initial production testing all but the fastest speed version of the part was re-classified to a 65 watt TDP.

Figure 2: New Product Timeline (1Q06-1Q07E)

Product Timeline



Source: Cowen and Company

Extensive Platform Muscle – A Competitive Advantage

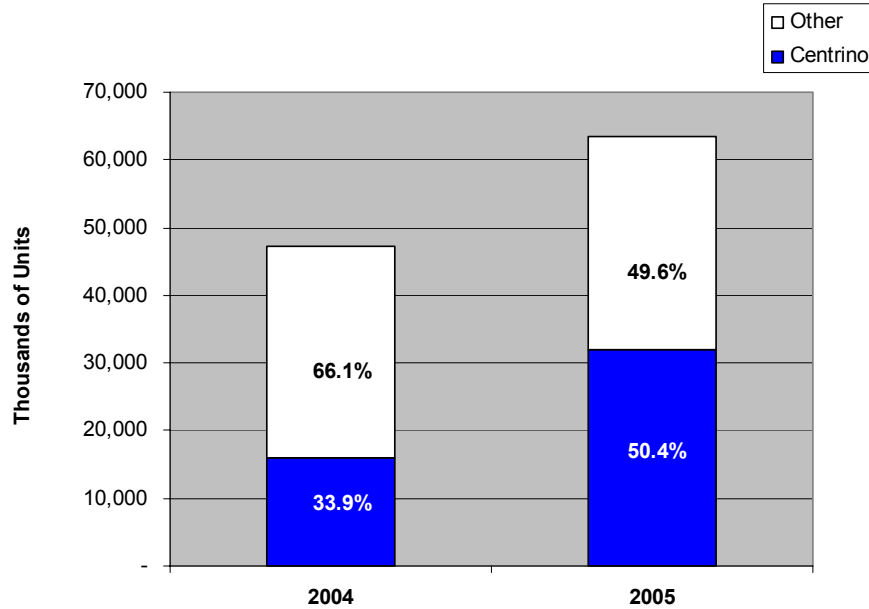
The significant success of Centrino, the first platform marketing initiative within the PC sector, demonstrated the power of a platform approach. We expect platform marketing to have a greater impact on all segments of the PC market and believe that Intel is significantly better equipped than AMD to win the platform battles for at least the next 12-18 months. AMD's recent announcement regarding its intention to acquire ATI would put the company one step closer to full platform capability. Assuming the merger closes, the company will have solid processor, chipset, and graphics capability. However, it is unlikely that the combined company will have any strong platform brands established in the marketplace for 12-18 months.

The success of the Centrino platform is shown in Figure 3. Centrino units grew by 100% in 2005 over 2004 versus the roughly 35% growth experienced by the mobile PC market as a whole. The corresponding gain in mobile processor shipments by Intel is only part of the story. As a result of the platform initiative, Intel significantly increased its dollar content per system by also shipping the chipset and wireless solution for every one of these systems. This is the true leverage of platform marketing: the ability of the platform brand owner (in this case Intel's ownership of the Centrino brand) to mandate the use of specific semiconductor components as well as other system requirements.

To truly execute on the platform approach the semiconductor supplier must possess two primary attributes, first, the marketing muscle to create the brand, and second, and the complementary products to financially capitalize on the brand. We believe the recent launch of consumer platform marketing initiatives by both Intel and AMD underscore the relative advantage of Intel in the pending platform battles. In January 2006, Intel launched the Viiv platform initiative. A Viiv-certified PC is a media center PC intended to address the consumption and management in the home of digital content such as television, movies, photos, and music. At approximately the same time, AMD re-branded the AMD Live! trade mark to define a comparable media center PC platform-brand. The current third-party support of these two brands underscores the relative marketing muscle, in our opinion. While AMD has garnered support for AMD Live! from numerous PC hardware and software players, Intel has garnered support for Viiv from not only the hardware and software players but also numerous digital content suppliers. At the time of launch ESPN, MTV, Virgin Records, Yahoo, Napster, and many others had signed up to provide digital content for Viiv-branded PCs. We are firm believers that it is content that will define the media center PC brand (assuming system price/performance are comparable), and hence we expect Intel's Viiv brand to gain a significantly greater mind share among consumers. In addition, Intel is much better positioned to reap the financial benefits of a media center PC platform brand. For a PC to be certified as an AMD Live! PC it must use an AMD dual-core Athalon 64 processor and other specific hardware and software components supplied by companies other than AMD. For a PC to be certified as a Viiv PC it must use a specific Intel processor, Intel chipset, Intel networking solution, and Intel software. With Intel's significantly larger financial return per system, it is difficult to see how AMD will be able to support the marketing dollars to better position its respective platform brands until it enjoys similar content per system.

Figure 3: Centrino Platform vs. Worldwide Notebook Shipments

	<u>2004</u>	<u>2005</u>
Centrino	16,000	32,000
<i>Growth Rate</i>		100.0%
<i>Market Share</i>	33.9%	50.4%
Mobile Market (Total)	47,180	63,470
<i>Growth Rate</i>	23.0%	34.5%



Source: Company presentation & Gartner Dataquest

Manufacturing Leadership to Drive Performance and Cost

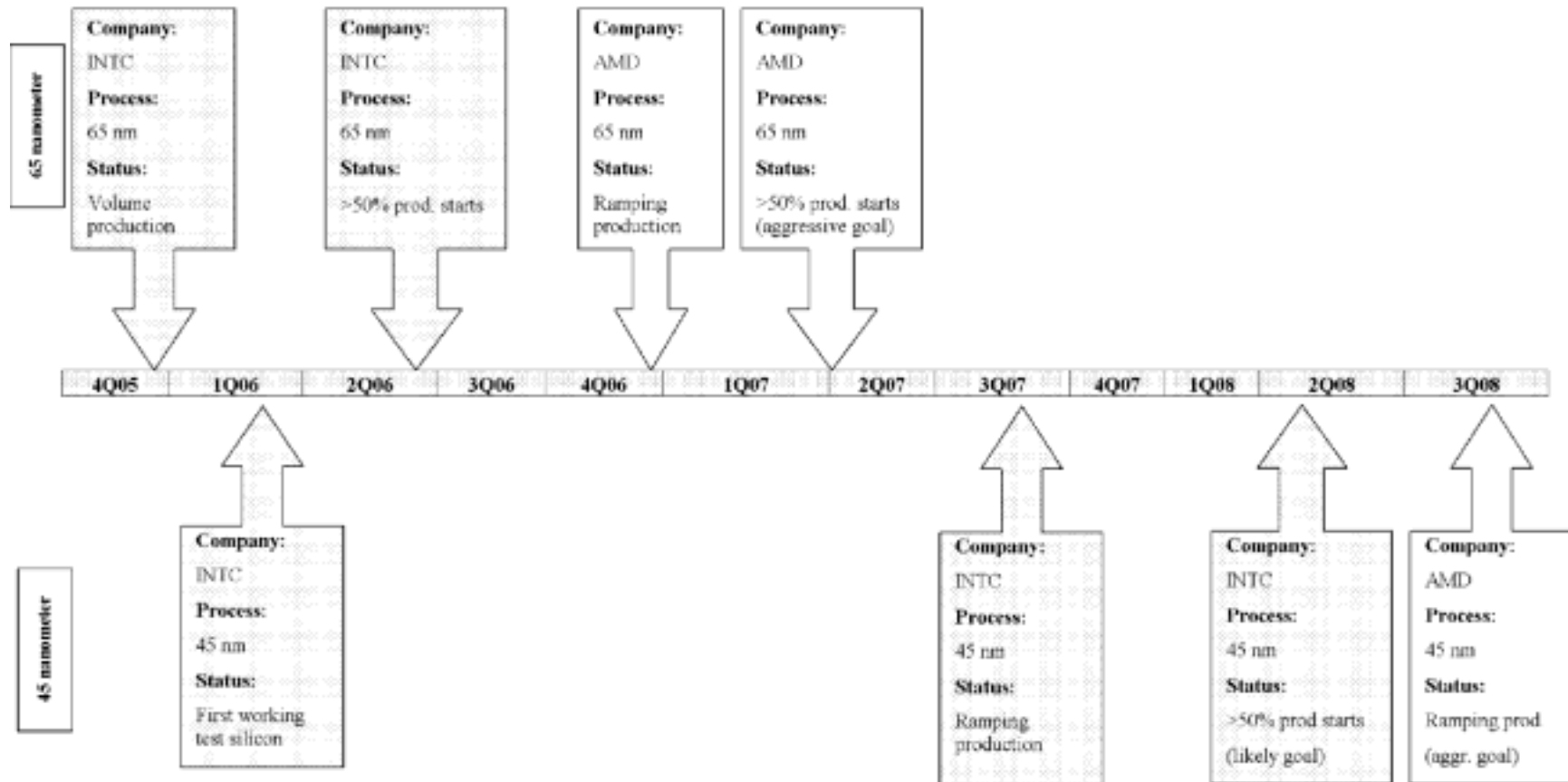
Manufacturing technology plays a very significant role in the microprocessor arena since it directly impacts power consumption, performance, and cost of a processor. We believe that Intel will enjoy a significant advantage over AMD in the manufacturing arena for at least the next year. We expect Intel to leverage this strength to both close the performance and power consumption gaps relative to AMD's products as well as to allow aggressive price moves with a more muted impact to the company's earnings. The end result is that the manufacturing competitive advantage should play a significant role in reversing recent market share losses.

The most advanced process node today is 65 nm, and Intel is significantly ahead of the competition when it comes to ramping production at this node. Figure 4 outlines the key production milestones for both Intel and AMD through 2008. While Intel entered 2006 already ramping production of 65 nm, AMD is not expected to begin volume production until the end of 2006. Intel currently has three fabs producing in volume at 65 nm, Fab 12 in Arizona, D1D fab in Oregon, and Fab24-2 in Ireland. Intel's rapid ramp of the 65 nm technology is evident in the fact that the company was producing more microprocessors utilizing the new 65 nm process than the

preceding 90 nm process as of June 2006. AMD is targeting to reach this crossover point in early 2007, a full six to nine months after Intel. Looking further down the road, Intel appears positioned to maintain this manufacturing leadership at the next process node, 45 nm. In January 2006, Intel demonstrated its first working test vehicle for the 45 nm process and appears to be on schedule for production ramp in the second half of 2007. AMD is hoping to ramp production of its 45 nm process 1.5 years after its 65 nm process, a cadence faster than the industry norm of two years. If AMD can attain this aggressive goal, it would result in a mid-2008 production ramp for 45 nm, a full a 6-12-month disadvantage to Intel.

Figure 4: Process Timeline - Intel vs. AMD (4Q05-3Q08E)

Process Timeline



Source: Cowen and Company

Streamlined and Humbled Organization – Better Prepared to Compete

Intel's recent significant loss of market share and longer-than-typical period without the performance leadership crown have undoubtedly humbled the organization. We believe this experience is driving change within the corporation that will improve its competitiveness and that investors will reward the resulting success from these changes with a higher stock price. The most important changes in our opinion are (1) streamlining efforts to focus on its core competency—microprocessors; and (2) flattening the organization to facilitate more rapid business execution.

Intel is best characterized as a company with tremendous architectural expertise in microprocessors, incredibly strong and broad-based brand recognition in the PC/server arena, and industry-leading manufacturing expertise. This highly enviable position has resulted in strong consistent profit generation. Over the last decade, as the company attempted to find uses for its growing cash position and offset slowing growth in the PC market, Intel attempted to enter other end-market verticals, most notably communications. It has been our long-standing belief that Intel would have limited success in these markets. This opinion is based on the fact that the majority of the communications verticals are characterized by a large number of part types with each only representing low to medium volume. This is in direct contrast to the PC market, which is characterized by a few part types in extremely high volume. We believe that Intel's manufacturing, design, marketing, and sales organizations are optimized for participation in markets that are driven by extremely high volume of a relatively few part types and, hence, their success would not port well to the alternate market structures. The lone exception to the low volume/high mix tendencies within the communications market is the wireless handset vertical. Within this segment we questioned customers' willingness to embrace Intel's sole-source and inflexible approach to engagement. In hindsight, it appears that these relatively unsuccessful initiatives outside the PC arena have only resulted in distracting many of Intel's most talented managers, likely contributing to the recent loss of competitiveness in the PC market. In addition, we would argue that, like most companies that enjoy long profitable runs, the management structure became bloated, robbing the company of its ability to react quickly to the rapid changes within the industry.

Changes at Intel are already under way. The first visible indication came in April, when Intel stated its object to reduce 2006 spending by \$1 billion and 2006 capex by \$300 million. In an effort to obtain a portion of the \$1 billion in targeted savings—but more importantly, to increase organizational efficiency—Intel eliminated approximately 1,000 management positions in July 2006. This was followed by significant reorganization of the management team reporting directly to the CEO, which we also expect will improve organizational efficiency. In addition, in June 2006, the company announced the sale of its communications and applications processor business to Marvell for \$600 million plus some assumed liabilities (expected to close in Q406). While we do not expect these changes to be the reorganization in totality, we do believe that they are major improvements and demonstrate the company's willingness and ability to execute significant and beneficial changes. All of these organizational modifications make the company more nimble and focused on its core competencies in the PC arena. We believe the company will be rewarded with improved market share and a resulting improvement in share price.

Investment Risks

Competition Unlike Ever Before – AMD Has Made Its Mark on the Ecosystem

We believe Intel is facing a competitive landscape different than ever before. Unlike in the past, when Intel only had to overcome short lapses of performance leadership, today the company is also facing an ecosystem that has embraced AMD as never before. In previous market share “recoveries” such as 1996 and 2002, new processor launches (the original Pentium and the Pentium 4 in 1996 and 2002, respectively) repositioned the company for performance leadership and resulted in rapid market share transition back to the Intel offering. So while we expect Intel’s pending, massive product refresh to reverse recent market share trends, we think the impact will be more muted than that seen in previous cycles given the changes in the PC ecosystem.

Impeding Intel’s instantaneous market share recovery, in our opinion, will be AMD’s new relationships with various players throughout the PC ecosystem as well as heightened awareness and acceptance by the end-consumer. The most glaring endorsements of AMD’s viability are Microsoft’s software and operating system support, Dell’s first-ever use of AMD processors, and Sun Microsystems’s partnership with AMD to drive its first x86-based server initiative. We believe it is extremely unlikely that these types of ecosystem players would completely abandon AMD as a result of Intel gaining the performance lead. We also believe that this extended period of AMD technical dominance has elevated the company in the minds of end-users. Unlike in previous periods, where only the most technically savvy consumer appreciated AMD’s capabilities, we believe a significant portion of consumers now recognizes AMD as a viable supplier of PC processors. Again, because of this we expect the AMD brand to be a little more “sticky,” with a shift in performance leadership viewed only as an interim situation as opposed to a signal to immediately abandon the brand.

How Much Will Customers Reward AMD’s “Kinder, Gentler” Approach?

AMD’s efforts to position itself as the more amiable supplier could impact Intel’s steady state market share. Intel has long been one of those suppliers that maintains a complicated love/hate relationship with its customers: they love Intel’s technology and brand recognition, but hate Intel’s willingness to utilize its resulting leverage. AMD has launched a full-scale attack on Intel’s customers by attempting to provide the technology without the pressure of leverage. While we expect this approach to resonate with many customers, we do not believe that the potential of a friendlier, more open supplier can broadly trump the potential profits of leadership technology and end customer brand awareness.

In our opinion, AMD’s “kinder, gentler” approach is rooted in its corporate culture as well as out of necessity. AMD is currently unable to offer customers complete platforms, whereas Intel has the ability to offer processor, graphics/chipset, and communications solutions. As a result, AMD cannot mandate what chips are to be used alongside its processor. However, Intel benefits significantly by having customers use its entire suite of chips and, hence, aggressively leverages its platform brands to encourage customers to do so. In what we would classify as a significant escalation on this front, AMD recently announced its Torrenza initiative. The premise of this effort is to provide third-party chip suppliers with detailed

specifications of AMD processors' architectures as well as high-speed connection interfaces to the processor to allow the development of application-specific co-processors. There is little doubt that co-processors can significantly improve the performance of a system. However, we question the economic feasibility of expanding significantly beyond high-performance niches such as gaming and some high-end servers/workstations.

Dealing With Slower PC Growth

As Intel slims itself down to focus on its core competency of PC processors and supporting chips, it will have to deal with the realities of slower growth. Gartner forecasts that PC unit sales will grow at a CAGR of 9.3% from 2005 to 2010. (See Figure 5.) This is well below the 12.6% CAGR enjoyed from 2002 to 2005. The bottom line is, this is the reality of the business. PC demand will likely ebb and flow from various catalysts such as the launch of new operating systems like Vista, the buying habits of emerging economies, and swings of economic cycles in more developed countries. We believe that Intel will have to remain vigilant at controlling the expansion of the organization to match this growth and resist the urge to chase higher growth in unrelated markets. We Intel's valuation to fluctuate over time as it reflects investors' changing perception of mid to long-term PC demand. If Intel remains vigilantly focused on the PC sector and returns its profits to shareholders as opposed to using them to chase other high-growth markets, we believe the stock will enjoy solid long-term returns.

Figure 5: Worldwide: Shipments of PCs by Device

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006E</u>	<u>2007E</u>	<u>2008E</u>	<u>2009E</u>	<u>2010E</u>	<u>CAGR</u> <u>'02-'05</u>	<u>CAGR</u> <u>'05-'10</u>
All PCs	148,156	164,035	183,367	211,586	232,956	255,183	278,256	304,573	330,417	12.6%	9.3%
<i>Growth (%)</i>	4.7%	10.7%	11.8%	15.4%	10.1%	9.5%	9.0%	9.5%	8.5%		
Deskbased	117,991	125,663	136,188	148,116	152,655	157,528	164,198	172,898	179,691	7.9%	3.9%
<i>Growth (%)</i>	3.1%	6.5%	8.4%	8.8%	3.1%	3.2%	4.2%	5.3%	3.9%		
Mobile	30,165	38,372	47,180	63,470	80,301	97,655	114,058	131,675	150,726	28.1%	18.9%
<i>Growth (%)</i>	11.5%	27.2%	23.0%	34.5%	26.5%	21.6%	16.8%	15.4%	14.5%		
Professional	97,085	107,343	120,142	135,652	145,726	158,099	172,388	187,886	201,471	11.8%	8.2%
<i>Growth (%)</i>	2.8%	10.6%	11.9%	12.9%	7.4%	8.5%	9.0%	9.0%	7.2%		
Home	51,071	56,692	63,225	75,934	87,231	97,083	105,867	116,687	128,946	14.1%	11.2%
<i>Growth (%)</i>	8.5%	11.0%	11.5%	20.1%	14.9%	11.3%	9.0%	10.2%	10.5%		

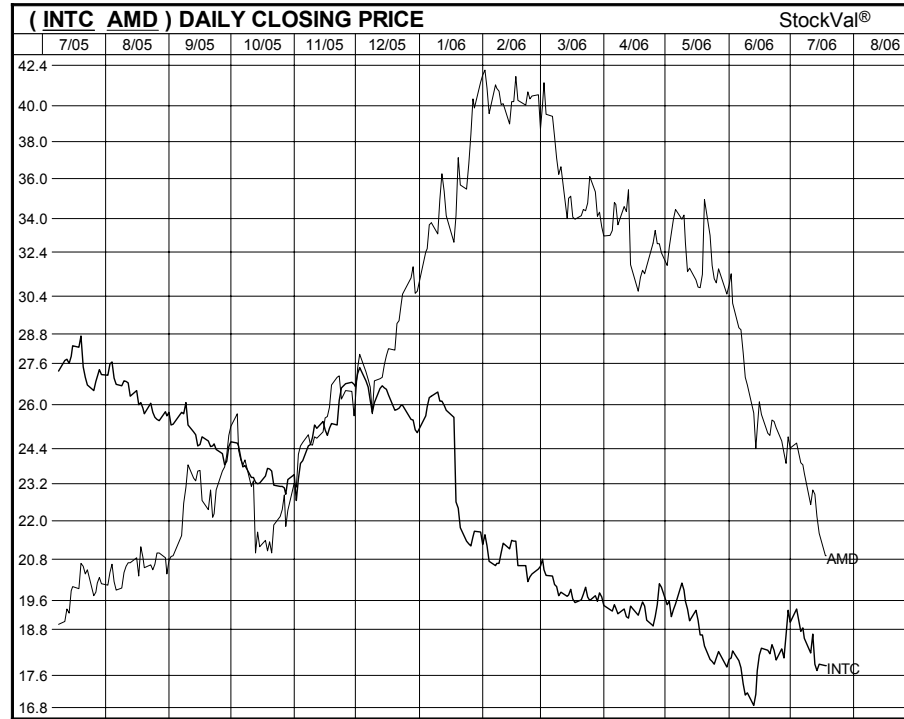
Source: Gartner Dataquest

Valuation

We believe Intel's will be able to reverse market share losses more quickly and significantly than many investors expect, and we believe that there is a strong probability that the company delivers healthy upside relative to consensus expectations by early 2007. Consequently, we believe that a 19-21x P/E multiple (2007) is achievable within the next 12 months, which suggests that the stock can outperform the market by 15-30% during that period.

As illustrated in Figure 6, INTC shares have absorbed a substantial decline (roughly 35%) in valuation throughout calendar 2006, and the stock currently trades in-line with its comps. However, we believe the components of a successful turnaround story are now in place, which should allow the company to deliver upside in fundamentals and subsequent valuations. After the seasonally weak summer months, we believe that tech investors maintain a results-driven / "show me first" sentiment. As highlighted in Cowen Tech Strategist, Arnie Berman's July 31 edition of *Technology Focus* ("Many Ways to Get Cremated, Few Ways to Hide"), investors continue to "seek refuge in stocks with relative strength," such as Outperform rated Texas Instruments (TXN, \$31.62). However, we expect investors whose stock-picking strategies favor "turnaround" stories to gravitate toward INTC as the company begins to show early evidence of success driven by the new product rollouts and company restructuring. We also expect shares of INTC to be supported by a broader trend in technology as we move through the seasonally strong second half. We expect multiples to expand in this time frame given that the overall industry is trading at depressed valuations that are consistent with those in 2004, when underlying fundamentals were significantly bleaker.

Figure 6: Price Performance – INTC vs. AMD (1/04 - 8/06)



Source: StockVal

Figure 7: Price to Forward Earnings Estimate



Source: StockVal

Recent Results and Forecasts

On July 19, the company reported 2Q06 (June) financial results, with revenue of \$8.0 billion and earnings of \$885 million, or \$0.15 per share. Revenue declined by 10% sequentially, coming in at the low end of the \$8.0-8.6 billion guidance range management provided at the beginning of the quarter and below Street consensus expectations of \$8.3 billion. As expected, management attributed the below-normal seasonal patterns to a deceleration in PC growth rates, resulting in above-average customer inventory levels, which are limiting demand in the short term. During the quarter, gross margin deteriorated 300 basis points sequentially, to 52.1% from 55.1% in 1Q06, yet above management's guidance of roughly 49%. The sequential decrease in gross margin was primarily attributed to a combination of lower unit volume, a higher proportion of lower-margin product in the overall mix, and lower microprocessor ASP. However, these gross margin declines were somewhat offset by qualification for production of new products (Conroe). Operating expenses came in at \$3.09 billion, toward the high end of management's guidance range of \$3.0-3.1 billion. The company recently initiated cost reduction measures, such as the layoffs of 1,000 managers, which should begin to benefit the company's expense structure in 4Q06. The company delivered EPS of \$0.13, which exceeded consensus expectations by \$0.02.

On the balance sheet, Intel maintains a cash and equivalents position of \$7.64 billion, down \$1.48 billion from \$9.12 billion in 1Q06. Days of inventory on hand increased for the fourth consecutive quarter, coming in at 102 versus 80 in 1Q06. Management indicated that this is primarily attributable to the qualification of the Conroe microprocessor for production ahead of expectations. Days sales outstanding were down 3 to 36. Stock repurchases were \$1 billion. Capital spending was \$1.7 billion, and dividend payments were nearly \$600 million.

Management provided a 3Q06 (September) revenue guidance range of \$8.3-8.9 billion, implying 3.6% to 11.1% sequential growth. In terms of gross margin, management provided guidance of 49%, down 210 basis points sequentially. Operating expenses are expected to track flat to down slightly coming in at approximately \$3.0 billion.

Figure 8: Revenue Segmentation

(Dollars in millions, except per-share data)

Fiscal Year - December	Fiscal Year 2004	Fiscal Year 2005	Mar '06 1QA	Jun '06 2QA	Sep '06 3QE	Dec '06 4QE	Fiscal Year 2006E	Mar '07 1QE	Jun '07 2QE	Sep '07 3QE	Dec '07 4QE	Fiscal Year 2007E
Microprocessors	19,426	19,412	3,892	3,338	3,522	3,870	14,622	3,762	3,754	4,152	4,688	16,356
Chipset, motherboard & other	5,352	5,725	1,255	1,283	1,334	1,461	5,333	1,420	1,417	1,568	1,770	6,175
Digital Enterprise Group	24,778	25,137	5,147	4,621	4,856	5,331	19,955	5,182	5,172	5,720	6,458	22,531
Microprocessors	5,667	8,704	2,347	1,958	2,134	2,369	8,808	2,262	2,199	2,375	2,612	9,449
Chipset and other	1,315	2,427	632	731	797	884	3,044	845	821	887	975	3,528
Mobility Group	6,982	11,131	2,979	2,689	2,931	3,253	11,852	3,107	3,020	3,262	3,588	12,976
Flash Memory Group	2,285	2,278	544	536	552	577	2,209	557	579	631	719	2,486
Other	165	280	270	163	167	177	777	166	151	157	177	652
TOTAL REVENUE	\$34,210	\$38,826	\$8,940	\$8,009	\$8,506	\$9,339	\$34,794	\$9,012	\$8,922	\$9,770	\$10,942	\$38,646
Percent of Sales												
Microprocessors	56.8%	50.0%	43.5%	41.7%	41.4%	41.4%	42.0%	41.7%	42.1%	42.5%	42.8%	42.3%
Chipset, motherboard & other	15.6%	14.7%	14.0%	16.0%	15.7%	15.6%	15.3%	15.8%	15.9%	16.0%	16.2%	16.0%
Digital Enterprise Group	72.4%	64.7%	57.6%	57.7%	57.1%	57.1%	57.4%	57.5%	58.0%	58.5%	59.0%	58.3%
Microprocessors	16.6%	22.4%	26.3%	24.4%	25.1%	25.4%	25.3%	25.1%	24.6%	24.3%	23.9%	24.4%
Chipset and other	3.8%	6.3%	7.1%	9.1%	9.4%	9.5%	8.7%	9.4%	9.2%	9.1%	8.9%	9.1%
Mobility Group	20.4%	28.7%	33.3%	33.6%	34.5%	34.8%	34.1%	34.5%	33.8%	33.4%	32.8%	33.6%
Flash Memory Group	6.7%	5.9%	6.1%	6.7%	6.5%	6.2%	6.3%	6.2%	6.5%	6.5%	6.6%	6.4%
Other	0.5%	0.7%	3.0%	2.0%	2.0%	1.9%	2.2%	1.8%	1.7%	1.6%	1.6%	1.7%
Y-T-Y Growth Analysis												
Microprocessors	8.0%	-0.1%	-21.3%	-27.5%	-28.7%	-21.5%	-24.7%	-3.3%	12.5%	17.9%	21.1%	11.9%
Chipset, motherboard & other	5.6%	7.0%	-11.4%	-8.2%	-7.0%	-1.0%	-6.8%	13.2%	10.5%	17.5%	21.1%	15.8%
Digital Enterprise Group	7.5%	1.4%	-19.1%	-23.0%	-23.8%	-16.8%	-20.6%	0.7%	11.9%	17.8%	21.1%	12.9%
Microprocessors	37.5%	53.6%	22.4%	-4.8%	-8.4%	-1.3%	1.2%	-3.6%	12.3%	11.3%	10.3%	7.3%
Chipset and other	36.1%	84.6%	22.2%	29.2%	24.7%	25.5%	25.4%	33.6%	12.3%	11.3%	10.3%	15.9%
Mobility Group	37.3%	59.4%	22.4%	2.6%	-1.3%	4.8%	6.5%	4.3%	12.3%	11.3%	10.3%	9.5%
Flash Memory Group	42.1%	-0.3%	-5.9%	1.5%	-3.5%	-3.8%	-3.0%	2.3%	8.0%	14.3%	24.7%	12.6%
Other	-57.5%	69.7%	342.6%	103.8%	247.0%	95.0%	177.5%	-38.4%	-7.1%	-5.7%	-0.2%	-16.1%
TOTAL REVENUE	13.5%	13.5%	-5.2%	-13.2%	-14.6%	-8.4%	-10.4%	0.8%	11.4%	14.9%	17.2%	11.1%
Seq. Growth Analysis												
Microprocessors			-21.0%	-14.2%	5.5%	9.9%		-2.8%	-0.2%	10.6%	12.9%	
Chipset, motherboard & other			-15.0%	2.2%	4.0%	9.5%		-2.8%	-0.2%	10.6%	12.9%	
Digital Enterprise Group			-19.6%	-10.2%	5.1%	9.8%		-2.8%	-0.2%	10.6%	12.9%	
Microprocessors			-2.2%	-16.6%	9.0%	11.0%		-4.5%	-2.8%	8.0%	10.0%	
Chipset and other			-10.4%	15.7%	9.0%	11.0%		-4.5%	-2.8%	8.0%	10.0%	
Mobility Group			-4.1%	-9.7%	9.0%	11.0%		-4.5%	-2.8%	8.0%	10.0%	
Flash Memory Group			-9.3%	-1.5%	3.0%	4.5%		-3.5%	4.0%	9.0%	14.0%	
Other			196.7%	-39.6%	2.2%	6.5%		-6.2%	-9.0%	3.8%	12.7%	
TOTAL REVENUE			-12.4%	-10.4%	6.2%	9.8%		-3.5%	-1.0%	9.5%	12.0%	

Source: Cowen and Company

Figure 9: Income Statement

(Dollars in millions, except per-share data)

Fiscal Year - December	Fiscal Year 2004	Fiscal Year 2005	Mar '06 1QA	Jun '06 2QA	Sep '06 3QE	Dec '06 4QE	Fiscal Year 2006E	Mar '07 1QE	Jun '07 2QE	Sep '07 3QE	Dec '07 4QE	Fiscal Year 2007E
Sales	\$34,209	\$38,826	\$8,940	\$8,009	\$8,506	\$9,339	\$34,794	\$9,012	\$8,922	\$9,770	\$10,942	\$38,646
COGS	14,463	15,777	4,012	3,838	4,260	4,644	16,754	4,496	4,478	4,648	4,882	18,505
R&D	4,778	5,145	1,562	1,496	1,481	1,466	6,005	1,488	1,503	1,533	1,564	6,088
SG&A	4,659	5,688	1,644	1,593	1,497	1,408	6,142	1,358	1,357	1,499	1,658	5,871
Amort. Of Intangibles (1)	179	126	19	10	10	6	45	0	0	0	0	-
Operating Income	10,130	12,090	1,703	1,072	1,257	1,816	5,848	1,670	1,584	2,090	2,838	8,182
Interest & Other Income, net	287	520	156	181	220	225	782	235	245	255	265	1,000
PreTax Income	10,417	12,610	1,859	1,253	1,477	2,041	6,630	1,905	1,829	2,345	3,103	9,182
Tax	2,901	3,946	512	368	450	622	1,953	572	549	703	931	2,755
Net Income	\$7,516	\$8,664	\$1,347	\$885	\$1,027	\$1,418	\$4,677	\$1,334	\$1,280	\$1,641	\$2,172	\$6,427
EPS	\$1.16	\$1.40	\$0.23	\$0.15	\$0.17	\$0.24	\$0.79	\$0.23	\$0.22	\$0.28	\$0.37	\$1.09
Diluted Shares Outstanding	6,494	6,178	5,954	5,868	5,873	5,878	5,893	5,883	5,898	5,888	5,903	5,893
Headcount				102,500		99,500						
Margin Analysis												
Gross Margin	57.7%	59.4%	55.1%	52.1%	49.9%	50.3%	51.8%	50.1%	49.8%	52.4%	55.4%	52.1%
R&D	14.0%	13.3%	17.5%	18.7%	17.4%	15.7%	17.3%	16.5%	16.8%	15.7%	14.3%	15.8%
SG&A	13.6%	14.6%	18.4%	19.9%	17.6%	15.1%	17.7%	15.1%	15.2%	15.3%	15.1%	15.2%
Operating Margin	29.6%	31.1%	19.0%	13.4%	14.8%	19.4%	16.8%	18.5%	17.8%	21.4%	25.9%	21.2%
Pretax Margin	30.5%	32.5%	20.8%	15.6%	17.4%	21.9%	19.1%	21.1%	20.5%	24.0%	28.4%	23.8%
Tax Rate	27.8%	31.3%	27.5%	29.4%	30.5%	30.5%	29.5%	30.0%	30.0%	30.0%	30.0%	30.0%
Net Margin (Cont. Ops.)	22.0%	22.3%	15.1%	11.1%	12.1%	15.2%	13.4%	14.8%	14.3%	16.8%	19.9%	16.6%
Y-T-Y Growth Analysis												
Revenues	13.5%	13.5%	-5.2%	-13.2%	-14.6%	-8.4%	-10.4%	0.8%	11.4%	14.9%	17.2%	11.1%
Gross Profit	15.5%	16.7%	-12.0%	-19.8%	-28.6%	-25.5%	-21.7%	-8.4%	6.5%	20.6%	29.1%	11.6%
Operating Income	34.5%	19.3%	-43.8%	-59.5%	-59.5%	-45.1%	-51.6%	-1.9%	47.8%	66.2%	56.3%	39.9%
Net Income (Cont. Ops.)	33.2%	15.3%	-38.2%	-56.6%	-48.5%	-42.2%	-46.0%	-1.0%	44.7%	59.9%	53.2%	37.4%
EPS (Cont. Ops.)	35.9%	21.2%	-34.8%	-54.0%	-46.2%	-40.2%	-43.4%	0.2%	43.9%	59.5%	52.5%	37.4%
Seq. Growth Analysis												
Revenues			-12.4%	-10.4%	6.2%	9.8%		-3.5%	-1.0%	9.5%	12.0%	
Gross Profit			-21.8%	-15.4%	1.8%	10.6%		-3.8%	-1.6%	15.3%	18.3%	
Operating Income			-48.5%	-37.1%	17.3%	44.5%		-8.0%	-5.2%	31.9%	35.8%	
Net Income (Cont. Ops.)			-45.1%	-34.3%	16.0%	38.2%		-6.0%	-4.0%	28.2%	32.4%	
EPS (Cont. Ops.)			-43.9%	-33.3%	15.9%	38.1%		-6.1%	-4.2%	28.4%	32.0%	

Source: Cowen and Company

Figure 10: Cash Flow Statement

(Dollars in millions, except per-share data)	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006E	Fiscal Year 2007E
Net income	\$5,641	\$7,516	\$8,664	\$4,677	\$6,427
Depreciation	4,651	4,590	4,345	4,700	5,170
Impairment of goodwill	617	-	-	-	-
Share-based compensation	-	-	-	-	-
Excess tax benefit from share-payment	-	-	-	-	-
Amortization of intangibles and acquisition costs	419	299	250	45	45
Purchased in-process R&D	5	-	-	-	-
Losses (gains) on equity securities, net	283	2	45	-	-
Net loss on retirements of PP&E	217	91	74	75	75
Deferred taxes	391	(207)	(413)	(275)	(275)
Tax benefit from employee equity incentive plans	216	344	351	350	350
Trading assets	(698)	(468)	1,606	193	(500)
Accounts receivable	(430)	(39)	(914)	(386)	(400)
Inventories	(245)	(101)	(500)	(224)	200
Accounts payable	116	283	303	162	(250)
Accrued compensation and benefits	276	295	296	(927)	400
Income taxes payable	(361)	378	797	(43)	-
Other assets and liabilities	417	136	(81)	146	-
Net cash from operating activities	\$11,515	\$13,119	\$14,823	\$8,493	\$11,242
Additions to property, plant and equipment	(3,656)	(3,843)	(5,818)	(6,200)	(6,763)
Acquisitions, net of cash acquired	(61)	(53)	(191)	-	-
Purchases of available-for-sale investments	(11,662)	(16,618)	(8,475)	(2,093)	(2,302)
Maturities and sales of available-for-sale investments	8,488	15,633	8,433	2,324	2,556
Investment in IM Flash Technologies, LLC	-	-	-	(500)	-
Other investing activities	(199)	(151)	(311)	(270)	(297)
Net cash from investing activities	(\$7,090)	(\$5,032)	(\$6,362)	(\$6,739)	(\$6,806)
Increase (decrease) in short-term debt, net	(152)	24	126	-	-
Additions (Repayments) of long-term debt	(137)	(31)	1,742	-	-
Excess tax benefit from share-based payments	-	-	(19)	-	-
Proceeds from employee equity incentive plans	967	894	1,202	1,504	1,654
Repurchase and retirement of common stock	(4,012)	(7,516)	(10,637)	(5,886)	(6,475)
Payment of dividends to stockholders	(524)	(1,022)	(1,958)	(2,056)	(2,159)
Net cash from financing activities	(\$3,858)	(\$7,651)	(\$9,544)	(\$6,438)	(\$6,979)
Net increase (decrease) in cash and equiv	\$567	\$436	(\$1,083)	(\$4,684)	(\$2,543)
Cash and equivalents, beginning of period	7,404	7,971	8,407	7,324	2,640
Cash and equivalents, end of period	\$7,971	\$8,407	\$7,324	\$2,640	\$97

Source: Cowen and Company

Figure 11: Balance Sheet

(Dollars in millions, except per-share data)

	Mar '05	Jun '05	Sep '05	Dec '05	Mar '06	Jun '06
	1QA	2QA	3QA	4QA	1QA	1QA
FY - December						
Assets						
Cash & ST Investments	\$13,673	\$12,600	\$11,951	\$11,314	\$7,854	\$6,421
Trading Assets - Fixed Income	2,108	1,883	1,632	1,095	1,265	1,222
Trading Assets - Equities	335	341	350	363	-	-
Accounts Receivable, Net	3,226	3,448	3,748	3,914	3,912	3,178
Inventories	2,808	2,739	2,815	3,126	3,552	4,332
Deferred Tax Assets & Other	1,328	1,179	1,228	1,382	1,429	1,602
Total Current Assets	23,478	22,190	21,724	21,194	18,012	16,755
Property and Equipment	16,321	16,624	16,825	17,111	17,618	18,098
Marketable Equity Securities	2,726	2,609	3,567	4,672	4,515	4,117
Goodwill and other Intangibles	3,716	3,805	3,814	3,873	3,873	3,871
Other Assets	1,325	1,285	1,430	1,464	3,161	3,247
Total Assets	\$47,566	\$46,513	\$47,360	\$48,314	\$47,179	\$46,088
Current Liabilities						
Short-term Debt	222	318	252	313	224	287
A/P And Accr'd Exp.	5,691	5,425	6,654	6,453	7,096	6,570
Deferred Income to Distributors	707	707	692	632	669	567
Inc. Tax Payable	1,977	1,330	1,901	2,008	1,849	998
Total Current Liabilities	8,597	7,780	9,499	9,406	9,838	8,422
Long Term Debt	464	430	432	2,106	2,040	2,054
Deferred Income Taxes	818	689	753	620	607	470
Other LT Liabilities	-	-	-	-	346	346
Total Liabilities	9,879	8,899	10,684	12,132	12,831	11,292
Stockholders' Equity	37,687	37,614	36,676	36,182	34,348	34,796
Total Liabilities And Equity	\$47,566	\$46,513	\$47,360	\$48,314	\$47,179	\$46,088
Other						
Capital Expenditures	1,788	1,389	1,282	1,359	1,788	1,738
Free Cash Flow	1,312	1,572	1,637	2,019	486	303
Dividend Payments/Stock Buybacks/Other	862	971			862	862
Free Cash Flow, after Buybacks	450	601	1,637	2,019	(376)	(559)
Actual Cash Flow	(1,052)	(1,298)	(900)	(1,174)	(3,290)	7,643
Liquidity						
Current Ratio	2.7	2.9	2.3	2.3	1.8	2.0
Quick Ratio	2.0	2.1	1.7	1.6	1.2	1.1
Cash/Current Liabilities	1.6	1.6	1.3	1.2	0.8	0.8
Leverage						
Debt/Total Capital	1.79%	1.95%	1.83%	6.27%	6.18%	6.30%
Management						
Sales/Inventory	13.4	13.5	14.2	13.1	10.1	7.4
Sales/Fixed Assets	2.3	2.2	2.4	2.4	2.0	1.8
Sales/Capital	1.0	1.0	1.1	1.1	1.0	0.9
Days Sales Outstanding	31	34	34	35	39	36
Invty Days-On-Hand	66	61	63	72	80	102
Profitability						
Return On Assets	18.3%	17.5%	16.8%	20.3%	11.4%	7.7%
Return On Net Assets	25.7%	24.0%	22.5%	26.5%	13.7%	8.9%
Return On Capital	22.7%	21.3%	21.4%	25.4%	14.7%	9.5%
Return On Equity	23.1%	21.7%	21.8%	27.1%	15.7%	10.2%
Per Share Data						
Book Value / Share	\$6.01	\$6.05	\$5.97	\$5.95	\$5.77	\$5.93
Tangible Book Value / Share	\$5.42	\$5.44	\$5.35	\$5.31	\$5.12	\$5.27
Net Cash / Share	\$2.46	\$2.26	\$2.16	\$1.70	\$1.15	\$0.90

Source: Cowen and Company

Figure 12: Return on Invested Capital

(Dollars in millions, except per-share data)	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006E	Fiscal Year 2007E
EBIT	\$7,533.0	\$10,130.0	\$12,090.0	\$5,847.8	\$8,181.9
+ Implied interest from operating leases	-	-	-	-	-
+ Increase in bad debt reserve	-	-	-	-	-
+ Increase in net capitalized R&D	-	-	-	-	-
+ Goodwill & Other Intangibles	3,705	3,719	3,873	4,067	4,270
Adjusted Oper Profit Before Tax	\$11,238.0	\$13,849.0	\$15,963.0	\$9,914.5	\$12,451.9
Income tax expense (from P&L)	1,801	2,901	3,946	1,953	2,755
+/- Decr/Incr in deferred taxes	989	755	250	(152)	(122)
Statutory tax rate	30.5%	30.5%	30.5%	30.5%	30.5%
Interest & other income (expense)	(91)	287	520	782	1,000
+ Tax benefit of interest on oper leases	-	-	-	-	-
- Taxes on other income	(27.8)	87.5	158.6	238.5	305.0
Cash Operating Taxes	\$2,817.8	\$3,568.5	\$4,037.4	\$1,562.0	\$2,327.6
NOPAT	\$8,420.2	\$10,280.5	\$11,925.6	\$8,352.4	\$10,124.2
Invested Capital					
Book value of common equity	37,846	38,579	36,182	34,348	36,065
+Minority interest	-	-	-	-	-
+Deferred taxes (L-A)	243	(512)	(762)	(610)	(488)
+Accumulated goodwill & other intagibles	3,705	7,424	11,297	15,364	19,634
+Total Debt	1,160	904	2,419	1,935	1,548
+Capitalized lease obligations	-	-	-	-	-
+ PV of operating leases	-	-	-	-	-
Invested Capital (incl goodwill)	42,954	46,395	49,136	51,037	56,760
Invested Capital (excl goodwill)	39,249	38,971	37,839	35,674	37,126
ROIC (incl goodwill)	19.6%	22.2%	24.3%	16.4%	17.8%
ROIC (excl goodwill)	21.5%	26.4%	31.5%	23.4%	27.3%

Source: Cowen and Company

Addendum

STOCKS MENTIONED IN IMPORTANT DISCLOSURES

Ticker	Company Name
AMD	Advanced Micro Devices
INTC	Intel
TXN	Texas Instruments

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Rating	Definition
Outperform (1)	Stock expected to outperform the S&P 500
Neutral (2)	Stock expected to perform in line with the S&P 500
Underperform (3)	Stock expected to underperform the S&P 500

(a) Assumptions: Time horizon is 12 months; S&P 500 is flat over forecast period.

COWEN AND COMPANY RATING ALLOCATION (a)

Rating	Pct of companies under coverage with this rating	Pct for which Investment Banking services have been provided within the past 12 months
Buy (b)	47.6%	10.2%
Hold (c)	44.6%	3.2%
Sell (d)	7.8%	0.0%

(a) As of 06/30/2006. (b) Corresponds to "Outperform" rated stocks as defined in Cowen and Company's rating definitions (see above). (c) Corresponds to "Neutral" as defined in Cowen and Company's ratings definitions (see above). (d) Corresponds to "Underperform" as defined in Cowen and Company's ratings definitions (see above). Note: "Buy," "Hold" and "Sell" are not terms that Cowen and Company uses in its ratings system and should not be construed as investment options. Rather, these ratings terms are used illustratively to comply with NASD and NYSE regulations.