Good day, ladies and gentlemen, and thank you for standing by and welcome to the Intel Corporation's first quarter 2013 earnings conference call. [Operator instructions.] I would now like to introduce your host for today’s conference, Mark Henninger, director of investor relations. Sir, you may begin.

Mark Henninger

Thanks, operator, and welcome everyone to Intel's first quarter 2013 conference call. By now you should have received a copy of our earnings release and the CFO commentary that goes along with that. If you've not received both documents, they are currently available on our Investor website, intc.com.

I'm joined today by Paul Otellini, our president and CEO; and Stacy Smith, our chief financial officer. In a moment, we'll hear brief remarks from both of them followed by the Q&A.

Before we begin, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it, and as such, does include risks and uncertainties. Please refer to our press release for more information on the specific risk factors that could cause actual results to differ materially.

Also, if during this call we use any non-GAAP financial measures or references, we'll post the appropriate GAAP financial reconciliations to our website, intc.com. Lastly, I'd like to highlight that this year and going forward, we'll be holding our Annual Investor Meeting in the fall, rather than in May. We will send out a further date notice this spring with all the important event logistics and we will look forward to seeing you there.

So with that, let me turn the call over to Paul.

Paul Otellini

Thanks, Mark, and good afternoon. As you know, I have a month left in my career at Intel, and this will be my last conference call with you. I’ve been doing these calls since 1993, and have done approximately 80 calls with you. I want to take a departure from my traditional remarks during this, my final earnings call. During the next few minutes, I’d like to share some perspective on the company and on our industry, drawing from my career and my experience as Intel’s fifth CEO.

I came to Intel nearly 40 years ago, eager to join the team of extraordinarily smart, creative, and driven engineers and the legendary team of founders, some of the greatest minds in technology. In 1974, Intel was still a startup, with revenues of $134 million and a culture built on relentless innovation and designed to thrive on change.

A revolution in computing had just begun, but it would take us another decade before we realized how dramatically it would change our business and the world. Amid all that change and reinvention, there has, however, been a constant. From the early days of DRAM to the era of the first microprocessor, from one architectural battle to the next, and across generations of form factors and operating systems, Intel has grown and thrived.

Naturally, constant change and reinvention creates plenty of room for both opportunity and skepticism. As the industry and the company evolved, risk and uncertainty were common, but the company's inventiveness, architectural innovation, manufacturing expertise, and intense drive allowed it to create and capitalize on the opportunity over the long haul.

In May of 2005, I became CEO and over the past eight years, we've executed a broad strategy to reposition the company to participate in all segments of computing by capitalizing on all of our considerable strengths.

We implemented the Tick-Tock model, which set the pace of innovation and has become an industry benchmark of execution. We developed the Atom microarchitecture to address low power and low cost market segments.

Through the acquisitions of Infineon Wireless Solutions and McAfee, we've invested in strategic capabilities like baseband technology and security that position us to deliver important new capabilities and compete across an even broader range of devices. And, we've invented and implemented manufacturing breakthroughs that are allowing us to deliver on the promise and competitive benefits of Moore's Law.

Never in the history of our company has our ability to participate across the spectrum of computing been greater. From industrial machines that are increasingly connected to the internet to the smallest battery powered devices, from traditional PCs to ultrabooks, and from high performance servers to microservers, storage, and networking equipment, we now compete wherever there is computing.

At the same time, we've put more distance between us and the rest of the semiconductor industry than ever before. In the first quarter, we shipped our 100 millionth 22 nanometer processor, using our revolutionary 3D transistor technology, while the rest of the industry works to ship its first unit.

That breakthrough is just one in a long history of materials science firsts, following innovations like string silicon and high-K metal gate. This leadership in materials science and manufacturing technology is the foundation on which our future success will be based, arming us the world's lowest power and lowest cost transistors.

But even as I prepare to pass the baton to a new generation of leadership, I know Intel's story is nowhere near completely written. I'm excited about what lies ahead for Intel. The company has a historically broad portfolio of products, spanning the spectrum of computing and price points, and as we begin to transition to 14 nanometer technology later this year, our architectural and [processor] technology investments and innovations will become increasingly apparent and valuable for our customers, and to the market.

Over the past few months, I've been traveling to our sites here in the U.S. and around the world. That creativity and drive that first attracted me to Intel almost four decades ago has never been higher. The company's core architectural and manufacturing strength have never been more valuable, and the opportunity presented by the evolution and expansion of the computing industry has never been greater.

It's for those reasons that I'm confident that Intel will continue to invent, grow, thrive, and deliver the best technology to a world increasingly hungry for the products of the microprocessor revolution. With that, let me turn the meeting over to Stacy.

Stacy Smith

Thanks, Paul. I'd like to take a minute and talk about what we're seeing in each of the segments of our business and our expectations as we look forward to the rest of the year. Starting with the PC client group. PC client volumes were down seasonally in the first quarter, consistent with our expectations. In addition, we believe the worldwide PC supply chain saw a continued reduction in inventory levels in the first quarter as customers decreased inventory of older generation PCs.

In the second quarter, we will launch Haswell, enabling a new wave of ultra-sleek designs across multiple form factors by our customers. We believe the combination of an improving macroeconomic environment, Haswell coming to the market; ultramobile form factors like ultrabooks, convertibles, and tablets; and touch-enabled devices leads to a return to growth in the second half of the year.

Moving to the data center group, data center group revenue in the first quarter grew 7% from a year ago. On a year on year basis, we saw significant growth in both the cloud and high-performance computing segments of the market. We continue to refresh our product line to expand our offerings across all ranges of performance, performance per watt, and performance per watt per dollar.

At IDF Beijing last week, we announced that our next-generation Atom processor for the microserver segment of the market, code named Avoton, and our Ivy Bridge product for Xeon [cloud] servers, will be shipping in the second half. These leadership products, coupled with our leading-edge [process] technology and the secular growth trends of the data [center] markets, give us confidence in double digit revenue growth for the year.

We are making significant progress in tablets and phones. First quarter tablet volume more than doubled from the fourth quarter, and we expect it to double again in the second quarter. We have shipping designs across both Windows 8 and Android operating systems. In the second half, we will launch Bay Trail, which will further extend our product line across screen sizes and price points.

In the phone segment, we had a good first quarter in our baseband business. We are shipping LTE versions today, and are on track to ship multimode voice and data LTE baseband solutions by the end of this year. We are winning designs with our new Clover Trail+ apps processor, where customers and third parties are highlighting both the performance and power efficiency of our architecture and are on track to ship our next-generation product, code named Merrifield, by the end of this year.

In other important segments of our business, we saw year on year growth in both our software and services group and our NAND business.

Turning to our financials, first quarter revenue finished at $12.6 billion, in line with our expectations. We are forecasting revenue of $12.9 billion for the second quarter, which is slightly higher than the average seasonal increase, as we expect some pipeline inventory replenishment as we launch Haswell and in anticipation of a stronger second half.

Gross margin of 56% was down 2 points from expectations. Increased demand from our customers allowed us to increase production of Haswell products prior to qualification for sale. The result of this was a higher than anticipated inventory writeoff, which we expect to get back throughout the rest of the year as the product is expected to qualify for sale in the second quarter.

In addition, we saw higher than expected excess capacity charges in older generation process technologies. We are taking advantage of the excess capacity on older generation process technologies to take capacity offline and reuse more equipment and space for 14 nanometer and beyond.

The results of these actions allow us to lower our capital spending forecast for the year by $1 billion, down to $12 billion. In addition, our inventories decreased almost $400 million from the fourth quarter. For the second quarter, we expect gross margin to increase 2 points to 58%, and the gross margin forecast for the year remains 60%, with gross margins in the second half back into the low 60s.

Operating income for the first quarter was $2.5 billion, with earnings per share of $0.40. Taking a look at the balance sheet, total cash investments ended the quarter at $17.1 billion, down $1.1 billion from the fourth quarter. The reduction in cash was the result of shifting almost $1 billion from short term to longer term investments.

In the first quarter, we generated approximately $4 billion in cash from operations, paid approximately $1 billion in dividends, purchased a little over $2 billion in capital assets, and repurchased $500 million in stock.

As Paul said, our manufacturing leadership is extending, and gives us the world's lowest cost and lowest power transistors. In the first quarter, we shipped our first silicon to a foundry customer, and we announced a significant foundry design win with Altera, who will move their leading edge products to our 14 nanometer process technology.

Building on this leadership, we are on track to start production on 14 nanometer process technology in the back half of this year. The combination of an improving macroeconomic environment and new products coming to the market over the course of the year to take advantage of our manufacturing leadership increases our confidence in being able to achieve financial growth in the second half of 2013.

With that, let me turn it back over to Mark.

Mark Henninger

Thank you, Paul and Stacy. Before we begin the Q&A, I do recognize that there are questions about the upcoming CEO transition. The selection process is on track, and the board's goal remains to name a successor by the time Paul retires at the annual shareholder meeting in May. Beyond this, we won't be offering any additional commentary on the status of the process or the candidates today.

Moving on to the Q&A, as is our long practice, we would ask each participant to ask one question and just one follow up if you have one. With that, operator, please go ahead and introduce our first questioner.

Question-and-Answer Session

Operator

[Operator instructions.] Our first question comes from Sumit Dhanda of ISI Group. Your line is now open.

Sumit Dhanda - ISI Group

Two questions for you. Stacy, it seems like notebook ASPs were up a little bit sequentially based on the data that you provided in the CFO commentary. Could you help us understand what that was due to? Was it enterprise versus consumer mix? Or was there a bigger proportion of touch that was shipped in the quarter?

Stacy Smith

There wasn't very significant change quarter on quarter in terms of notebook ASPs. I would just characterize it as a fairly benign pricing environment. The way we characterized it at the beginning of the year is that we have, I think, a strong product position really across different form factors in the market, and it played out as we expected. So I'd characterize that as just not a lot of change from the way we saw things a quarter ago.

Sumit Dhanda - ISI Group

And then for my follow up, just on the server piece, the last couple of quarters units were pretty flat, and then volumes were down [6%] in the calendar first quarter. I would have thought that would be easy comps. You might have seen a slightly better volume pickup in that business. Anything you could talk to with respect to why that did not occur?

Stacy Smith

On a year over year comparison, units were up, and ASP was up a little bit in the data center group. I think it's a little bit of an improvement of what we saw in the fourth quarter in the enterprise segment of the data center. And then we continue to see very robust growth rates across the high-performance computing and the big [IT] data centers that support the cloud. So it's a nice continuation of growth in those segments, and a little bit better in the enterprise segment. And as I think forward to the back half of the year, my suspicion is we'll start to see the enterprise segment growing again just based on macroeconomic improvement.

Operator

Our next question comes from Ambrish Srivastava of BMO Capital Markets. Your line is now open.

Ambrish Srivastava - BMO Capital Markets

A couple of questions. My first one is Stacy, if you could please talk about the capacity. How much of the capex can be moderated lower, if the PC industry continues to be weaker than probably what you thought going into the year?

Stacy Smith

I think we're really well-positioned right now from a factory and utilization standpoint. And let me just realign what we did in the first quarter. We saw that units were a little bit weaker than we expected and our expectations came down a bit. That allowed us to bring utilization down on some older generation process technology.

You can see we brought our inventory levels down pretty significantly, and actually a little bit more than I thought when I started the quarter. And we took $1 billion out of capex by rolling forward some older generation technologies to offset things that we needed to buy for 14 nanometer and new process technologies.

In terms of your question of the levers that we have, I think that's a good example of how we can be responsive in a very tactical time horizon to changes in demand. And as I look forward across the year, the prediction right now is we're going to run at a healthy rate of utilization. In fact, we're starting the quarter at that utilization rate. I think inventories will continue to be healthy.

If demand turns out to be stronger, we have some white space that we can grow into, so we can respond up. If demand ends up being a little weaker than we thought, you saw the playbook in Q1. We can pretty quickly react and bring capex down if that's the case.

Ambrish Srivastava - BMO Capital Markets

And then my follow up on the foundry strategy, maybe for Paul or for you, what's the long term vision. Getting Altera was a feather in your cap, but then looking out ahead, what implication does that have for business mix and also for the long term margin structure for the company?

Paul Otellini

I've described the strategy before as a crawl, walk, run strategy. We're past crawling. We're in the mode of collecting serious customers. The design win activity leads the announcement activity, as you'd expect in this business, and there are some other customers that we still have not yet publicly announced.

In terms of the business, as Stacy said I think last quarter, it will not have a significant revenue impact to the company for two to three years. That's the design cycle for these products. And in the case of someone like Altera, the products tend to run for quite some time. So think of that as something that will start two-plus years from now and run for quite a number of years thereafter on several generations of technology.

The business model that we have for the foundry assumes value based pricing. The people that we are soliciting and people that are attracted to us are those who see the advantages of our technology as it manifests itself in their products and gives them an advantage in the marketplace. So it's a healthy business for us.

Operator

Our next question comes from John Pitzer of Credit Suisse. Your line is now open.

John Pitzer - Credit Suisse

First, just relative to what your units did in PCG versus some third-party data and kind of your commentary that you thought that the PC supply chain went through an inventory reduction. There seems to be a little bit of a mismatch, where you guys have outperformed. To what extend is that just netbooks not being classified in your PC group and being classified in third-party data, and to what extent is that emerging market strength perhaps picking up that the third-party data's not sort of capturing?

Stacy Smith

I'll start by saying when you take into account all of the different categories that the third parties are looking at, I think we're pretty aligned with how they view the year. And so you start with the traditional PC segment of the market, we do expect that to be down. We expect netbooks to be down significantly. You can see that in our other IAG results, and in fact it's getting close to zero. That category is coming to the end of its life.

And then we see some of the new form factors of computing are growing significantly. Gartner would call those ultramobile devices, so things like ultrabooks, detachables, convertibles. We're seeing robust growth there. And then we're now participating across a broad range of tablets between Windows 8 and Android. And with Bay Trail coming out and Merrifield behind that, we start to participate in a much broader set of screen sizes and price points than we are today.

And so when you net all of this up, and you look broadly at the market for computing, you see some of the traditional form factors down. You see growth in these new form factors. We get to kind of very slight unit growth for the year and that's pretty consistent with how the third parties are viewing the year.

John Pitzer - Credit Suisse

And then Stacy, as my follow on, just the operating profitability of DCG was down about 500 basis points sequentially. And I guess it's the lowest in the data set that I'm looking at. Is that incremental opex you guys trying to broaden out into new areas like networking and storage? Is that a gross margin problem? Can you help me understand the profitability? And when do we get back to that 50% op margin that we saw maybe five quarters ago, if ever?

Stacy Smith

It's a combination of two things, and you'll notice that it's also impacting PCG. As we said at the beginning of the quarter, we had significant excess capacity charges that hit both PCG and DCG, and we had a big increase in startup costs as you kind of expect, based on where we are in the 14 nanometer ramp, and those two business units are the ones that really drive both of those, and so that's where those costs hit.

So as the gross margin improves, we expect that Q1 is the bottom. It's up a bit in Q2, and then a back half that's back into the low 60s. You'll see the operating profit moving back into what you've historically come to expect in DCG.

Operator

Our next question comes from Chris Danely with JP Morgan. Your line is now open.

Chris Danely - JP Morgan

I guess my first question is on the foundry business. Paul, you said the response has been tremendous. You've also, in the past, said that you probably wouldn't take any business that was ARM processor/potential competitor to yourself in the PC or the handset arena. Has that stance changed at all?

Paul Otellini

No, it hasn't. I think the ground rules that we've laid out, I have three that I was looking at. One would be value-based pricing, to take advantage of our technology. The second is that we would not enable a chip competitor. And the third, that we have not mentioned on the call yet today, is that it would be great if we could form a strategic relationship with a customer so that it went beyond just a single foundry transaction.

Chris Danely - JP Morgan

And then for my follow up, if you look at the sequentials for Q1/Q2 this year, it's pretty similar to last year. I know none of us want a repeat of the second half of last year. Could you just maybe compare and contrast, and what gives you confidence that we're not going to see a repeat of last year in the second half of the year for sales?

Stacy Smith

What gives me confidence in the second half of 2013 really comes down to two things. One, we do expect that the macro environment will improve. That's consistent with what we're seeing from most economists now. That could be a repeat to what we thought last year. I think the world was expecting a stronger macroeconomic second half of '12, but it didn't materialize. So that is my believe right now.

That will directly impact our data center business. There's a big portion of that business that really is correlated to GDP growth when you look at it over a long period of time.

And then secondly is our product portfolio, and we now participate across a broad range of devices, tablets and convertibles and attachables, and phones, although phones won't really drive the results in the second half. And so we can embrace this broad market for computing now, and wherever the demand increases, we can participate in it.

And a year ago, we were in the middle of that transition, and so as tablets ramped, and in particular as [unintelligible] tablets ramped, we really weren't in a position to participate in those segments of the market.

Paul Otellini

I had a third thing, Chris, which I think is as the OEMs start looking at new form factors that they can design around our new chips, Haswell in particular, and maybe Bay Trail, and Windows 8, enabling touch, the explosion in form factors and the competitiveness of that platform is going to be substantially different, at price points down into the $300 to $400 range enabling touch. We didn't have that last year. So you go into the prime selling season with new products, new technologies, new form factors, and new capabilities that, up to now, were unapproachable price points.

Operator

Our next question comes from Ross Seymore of Deutsche Bank. Your line is now open.

Ross Seymore - Deutsche Bank

My first question, moving on to the DCG side, again, I know you said, Stacy, that you're confident in double-digit growth for the year and that macro is a big part of it. Is there any sort of granularity you can give us to get us across that bridge from what seemed to be a relatively weak start to the year, whether by the end markets within that segment or new products? Anything you can help us with would be great.

Stacy Smith

I'll give you a little bit of color commentary on Q1, just so you can kind of see what we're seeing in terms of growth rates. If you look at the traditional enterprise segment of the market on a year over year basis, as I said earlier, it's growing a little bit, but think of it as a pretty low growth rate. And that's compared to the last couple of quarters, where we saw that market in decline. So I think you'd say it's improving, but it's not robust.

And then we continue to see very high rates of growth in things like the cloud and high-performance computing. And when I say high rates of growth, think of things that are in the 20%, 30%, 40% year on year unit growth rates in those segments of the market. I think that second piece is really a secular driver. It's all these devices computing, connecting to the internet, driving the [unintelligible] out of the cloud. And then the first piece, I think, is improving and will likely improve into the second half.

Ross Seymore - Deutsche Bank

I guess for my follow up, thinking a little bit about inventory and how it plays along into utilization. You guys over the last two quarters have taken the better part of $1 billion out of your inventory. A year ago at this time, you started ramping that back up, then obviously demand was a problem and you had to go back to the underutilization side of things.

Are you going to be a bit more cautious on the pace of utilization and inventory build this year, or are some of the things macro-wise and product-wise that are giving you confidence in the back half demand is going to lead you to the same behavior or just as aggressive as a year ago?

Stacy Smith

I think we're on a path where inventory levels in the year are no more than what we have today and likely less than what we have today. I think we're all learning how to operate more efficiently. Now, it may go up a little bit in the second quarter as the various versions of Haswell qualify, which is part of the story for the Q1 margin miss. And it will continue to manage things very lean.

And as I said in answer to a question earlier, we're now in a really nice position where we have the capability to flex capacity up if we need to, and so they don't need to run with big inventory levels.

Operator

Our next question comes from James Covello of Goldman Sachs. Your line is now open.

James Covello – Goldman Sachs

The last time PC units were at this level was Q2 '09, and your quarter capex was less than $1 billion. It was $981 million. The full year capex guidance implies you're going to be spending three times that amount in quarterly capex for the rest of the year. Why do you need that much capacity when units are at the same levels as then?

Stacy Smith

Let me put capex in maybe a broader context. First, if you take out the 450 mm, we're down a couple billion dollars from where we were last year. Pretty significant reduction. And if you just look at our capital spending as a percent of revenue relative to the last several years, we're in the high teens and the last couple of years we've been in the low 20s. So I think we're kind of in the range.

And you compare that against some of the people we compare against, a TSMC or a Samsung, they're spending some significant multiple of capex relative to revenue than what we are. So I think we're spending the right amount. I think we can be responsive if the market ends up a little bit weaker. I think we have the ability to flex up if the market ends up being stronger. I'm very comfortable with our positioning.

And as I just discussed with Ross, the operational indicators look really good. I think we're at a healthy level of inventory. We brought it down to $400 million this quarter. We're running healthy utilization, and I expect both of those to continue through the year.

James Covello - Goldman Sachs

I absolutely appreciate the perspective around the numbers, but it still doesn't really answer why it needs to be 3x higher than when units were at the same level.

Stacy Smith

I think if you do any quarter compare, capital spending tends to be over a long period of time. So if you look at it on an annual basis, what we're forecasting for this year is kind of down a little bit on a percent of revenue relative to what we spent in '10, '11, and '12. 2009 is a weird comparison point, because you're in the aftermath of the financial meltdown, and as we disclosed to you at that time, that gave us the ability to roll forward entire factories full of equipment from one process generation to the next. I think if you choose that particular time period, you're going to a weird compare.

James Covello - Goldman Sachs

Okay, I was just picking it because that's the last time units were at this level, but I understand. That's helpful. Thank you.

Operator

Our next question comes from David Wong of Wells Fargo. Your line is now open.

David Wong - Wells Fargo

Just to clarify some of the numbers, you mentioned the 450 mm spending. Is that still assumed to be about $2 billion for this year and therefore your spending on your core capex for this year is planned to be about $10 billion, down from $11 billion last year? Is that the way the numbers work?

Stacy Smith

Yes, that's correct.

David Wong - Wells Fargo

And the other thing is, in your full year revenue guidance, can you give us any idea of roughly what percentage of full year sales might be related to tablets and smartphones, what's assumed for that?

Stacy Smith

Let me take it at a higher level, and I'll get to that, but the short answer is smartphones, it doesn't move the needle for us from a revenue standpoint as we've said. We're in the design win phase there. Tablets is interesting, but I want to talk about that in the context of kind of the broader market for computing.

So let's start with the data center. It's about 20% of our revenue. We've said we expect it to be double-digit growth. So if you just do simple manager math, that says it's just the data center is giving a couple of points, maybe a smidge more than that, to the company's growth rate that we've said is low single digits. So just the data center kind of gets us there.

Within the broader market for computing, it's the answer I gave John earlier, which is we're seeing a decline in some of the additional form factors. We're seeing an increase in things like ultrabooks, convertibles, tablets. We're refreshing our product line there. When you net all that out, you get to some very modest unit growth across all of those devices.

So think of that as being flattish, up a smidge. And then the rest of it is relatively small compared to those two businesses. And that's how you get to low single digit growth for the company.

Operator

Our next question comes from Vivek Arya of Bank of America Merrill Lynch. Your line is now open.

Vivek Arya - Bank of America Merrill Lynch

My first question is so far Windows 8 traction has been well below expectations relative to your last earnings call. So what specifically in Haswell can help turn it around? And can you give us a sense of how your customers are thinking about how they will roll out products when Haswell comes around? What will really change in the landscape to improve PC market traction?

Paul Otellini

With Haswell, there's a number of things. First of all, the overall performance goes up, graphics performance goes up, as well as the integer performance. So it's a better punch in the package than we've had with Ivy Bridge. Point one. Point two, the power envelope, or the batter life for that level of performance, is exceptionally better than Ivy Bridge.

Third, it gets into the form factor innovation and the integration with touch as I spoke about earlier, which I think is really part of the recipe required for Win 8 adoption. I've recently converted personally to Windows 8 with touch, and it is a better Windows than Windows 7 in the desktop mode, when you implement the touch and the touch-based applications and operating environment. It's just a lot easier to use.

There is an adoption curve, and once you get over that adoption curve, I don't think you go back. And we didn't quite have that same kind of adoption curve in Windows 7 versus XP before it. This requires a little bit of training. And I think people are attracted to touch, and the touch price points today are still fairly high, and they're coming down very rapidly over the next couple of quarters.

Vivek Arya - Bank of America Merrill Lynch

And as my follow up, Stacy, the buyback slowed down to I think about a $500 million in the last quarter. You were above $1 billion in prior quarters. How should we think about buyback activity for this year? How should we think about overall users of cash for this year.

Stacy Smith

As I think you know, we don't share prospectively what we're planning to do with the buyback, just as a matter of policy. What I can share with you is that our priorities are still the priorities that we've been talking about. It's investing in our business first, it's dividends second. And I shared with you the expectation that we want a dividend that's on the order of 40% of free cash flow. And I think that's giving us a pretty good dividend yield today.

And then buybacks we use as the other way to return cash to shareholders and to modulate cash balance. And so what you can take from less buybacks is just that I'm comfortable with the cash balances.

Operator

Our next question comes from Stacy Rasgon of Sanford Bernstein.

Stacy Rasgon - Sanford Bernstein

You spoke before about your increased confidence now versus last year. But if I'm just looking over the last three months, we have weaker results in Q1, which raises the operational bar for the second half, on both top line and gross margin, which suggests you're even more confident in that back half ramp than you were three months ago, even in the wake of what looks to be pretty challenging market data. You're also taking capex down, though, which would belie that increased confidence some.

I was just wondering, could you help me identify the sources of that increased confidence in that back half ramp versus where you were three months ago, as well as help me rationalize that with the cut to the capex outlook.

Stacy Smith

First of all, just to make sure I'm not oversoaking things here, you really just need seasonal from where we are in order to achieve the low single digit revenue growth. So I don't think we have a hugely high bar out there, and I went through a dissection of where I think the revenue comes from.

In terms of the things that give me confidence, or at least I personally believe it could be better than seasonal, it's the things we talked about, improving macroeconomic environment, the fact that we now are participating across a range of compute devices, and so the mix between those don't impact us nearly as much.

And then third, as Paul said, you have innovative form factors coming out in ultrabooks, in convertibles, and in detachables, that are hitting these really compelling mainstream price points that are touch enabled. And as we get into the Christmas selling season, your expectation is you will see touch-enabled ultrabooks that are $499 and $599 pretty commonly out there. $599 commonly, and $499 as kind of special SKUs.

And then we'll see, because of Bay Trail coming into the marketplace, you'll see touch-enabled thin notebooks with really good performance that are hitting kind of $300 price points. And then with our Android tablets, you'll see things that are significantly, [hey, I have that]. So we'll be participating across a broad range of compute devices as we get into the back half of this year.

Stacy Rasgon - Sanford Bernstein

For my follow up, I wanted to dig a little bit into the trajectory of your fab output. It sounds to me like your current [time] to loading is similar to what you had last quarter, which I think was full fabs on the second half. It almost sounds like you may be running close to full right now.

What does that mean for your expectations for how much your fab output may grow in 2014, year over year. I would think you anticipate running full in 2014, and we were pretty lean in the first part of 2013. Would double digit upside be the right way to think about that in terms of fab output? And how much of that increase might be inventory replenishment versus demand upside?

Stacy Smith

I think it's early to talk about 2014 at this point. We have the ability to respond to lots of different volume scenarios for 2014. If it's large, we can put on more capacity. If it ends up being closer to a bust, we can play the playbook we played…

Paul Otellini

We've also got the technology transition to the 14 nanometers. [unintelligible] a first order, all of our spending is focused on 14 nanometers , which gives us a fairly significant ramp capability. If demand for older products exceeds what we could build on 14, we could still build 22 for quite some time. So I really think it depends on whatever demand scenario you see out there. In any event, the most important thing for us is to make that transition to 14 and continue to have the leading edge.

Stacy Rasgon - Sanford Bernstein

And I understand that. Just mathematically, though, if I'm running full in 2014 and I was pretty empty in the first part of 2013, even if you're not adding a tremendous amount of capacity, doesn't that imply a very significant uptick in your fab output in '14 versus '13, if '13 is flattish to '12, and in '12 we already had too much? Mathematically, what does it imply if you're running full in 2014 even if you don't add anything?

Paul Otellini

We haven't talked about 2014.

Stacy Smith

Yeah, and I think what you're equation misses there is that we roll forward capacity. So we take capacity offline. Think of the change in capex at a first approximation of we took older generation technology offline a little faster than we thought. And we offset stuff that we were going to buy to make the transition and to build towards that 14 nanometer peak. We don't actually have to choose the 14 nanometer peak today. We can continue to refresh capital.

Stacy Rasgon - Sanford Bernstein

I understand. I'm just saying if you're running full in 2014, and you're not full for '13, how much would your output [go up]? Forgetting transitions and 14 nanometers and capex, just on a rough basis, how much are we talking about in terms of increase?

Stacy Smith

If we're running full in 2014. I mean, I'm not sure how to answer that question, because I don't yet know how much capacity we're going to put in place for '14.

Mark Henninger

And Stacy, I think at that point we'll want to move on to the next questioner. I'll be happy to follow up with you a little bit later.

Operator

Our next question comes from Doug Freedman of RBC. Your line is now open.

Doug Freedman - RBC

In the past, when you looked at Intel you were successful because your customers were successful. And right now I think it's general perception that the PC ecosystem is really not in the greatest state of health. What is it that you think Intel can do to try to make your customers more successful in the marketplace?

Paul Otellini

I think continue to give them the tools to innovate. And I wouldn't paint the entire customer base with the same brush that you just did. Certainly if you looked at the last quarter, even inside the PC space, Lenovo outperformed everybody else, and actually had a very good year on year set of numbers, in a down year. Apple continues to do well.

Subsets of customers in different segments are also doing very well in terms of, say, those. Those providing products into the internet data centers. What I see when we look out is a tremendous amount of innovation, particularly at the ODM and Taiwanese OEM side, where the ability to miniaturize and bring things into extremely thin form factors is as revolutionary as the amount of changes I've seen in my time in this industry.

And so I think what we can do is give them the products, like Haswell and Bay Trail to innovate around. We can help them with other feature sets like voice and speech that go around them, and just help them build better products.

Doug Freedman - RBC

When we look at sort of what we're seeing Intel do strategically, that is investing in things outside of what we call core PC, how do I try to quantify how big an investment you're willing to make in things such as the set top box or in the foundry efforts or other areas of revenue that the company is seeking?

Paul Otellini

I don't look at things with quite that level of granularity. The foundry thing, the investment is really going to be taking advantage, at least near term, with the current customer base, of capacity that we're already putting in place. That doesn't mean that at some point we won't have to actually build extra capacity for a foundry customer or a foundry business, but today, up to this point, it's certainly within our ability to absorb.

The set top box spending, or the stuff we're doing in Intel media, in the grand scheme of things, is not a lot of spending. So the real issue is inside of our core microprocessor and platform development, and we're at the point now where roughly half of our spending is focused on system on chip, inside the microprocessor world.

And the system on chip environment is really a lot of the ultramobile products. It's the phones, it's the tablets. It's embedded systems. It's automotive, etc. Where we have fairly strong growth opportunities. So it's not the same monolithic Tick-Tock model that we put in place eight years ago.

Mark Henninger

Operator, we'll go ahead and take two more questions.

Operator

Our next question comes from Joseph Moore of Morgan Stanley. Your line is now open.

Joseph Moore - Morgan Stanley

My question is on the commentary that the pipeline inventory replenishment will be a driver for slightly higher than seasonal Q2. Can you put some perspective on that? It seems like you normally have new products in Q2, and you normally have strength in Q3. Is the current inventory level lean, or how should we view that inventory replenishment comment?

Stacy Smith

I think inventory levels generally are lean everywhere we look. We saw an inventory burn in the broader pipeline in Q1. And our inventory levels are down more than I expected when I started the quarter, and down pretty significantly. So I think inventory levels are lean.

And I also want to put it in perspective. You're talking a minor difference. Being up 3% quarter on quarter is kind of well within Q1 the Q2 seasonality. I don't think there's any one big driver there. I think we'll see people putting in place some Haswell based systems in anticipation of the second half selling season, just as they burned inventory on some of the older generation systems in the first quarter.

Joseph Moore - Morgan Stanley

And then in terms of ultrabook, last year you had given pretty precise targets on where you wanted that to come out as a percentage of consumer notebooks. To the extent that you're willing to talk about it, can you give us any kind of qualitative assessment of where you think those penetration numbers will go this year, and any kind of goals or targets that you may have?

Stacy Smith

There's a market for ultrabooks, and it's a sizable market. I mean, if you look at Gartner data, it's growing robustly. But there's this reinvention going on just broadly across the notebook. And we're seeing now the percent of thin and light notebooks relative to the total notebook market that are kind of on the order of a third of the market. And I think that grows from here as we hit price points.

So I think the reinvention of the form factor is well underway. Some of those are going to be more premium ultrabooks with touch and then new form factors of convertibles and detachables. A big chunk of that is going to be that wedge of volume behind that, which are thin and light touch enabled notebooks that aren't categorized as ultrabook. All of that is good for us.

Operator

Our final question comes from Timothy Arcuri of Cowen & Company. Your line is now open.

Timothy Arcuri - Cowen & Company

I wanted to ask a question about the mix between bricks and mortar and equipment spending. You had said before, when you had guided core capex minus the 450 mm spending of '11 flat, you said the equipment portion would be up pretty sizably year over year. So since you cut $1 billion out of that, will the equipment portion still be up? Or is it now down?

Stacy Smith

I haven't looked at that math. You're right. The way I characterized it, we spent about 40% of our capex in 2012 on equipment. That percentage came down in 2013. More of the cut to capex was equipment than realignment of space, so I'd have to go back and look at the map. And that's typically something we share with you in the November investor meeting, to just kind of give you a sense of where is the capex going and then some color commentary over the next couple of years.

Timothy Arcuri - Cowen & Company

And then just second thing, you just gave some price points for touch-enabled notebooks that I look back at my notes and you were previously saying $599 to $799 for touch-enabled notebooks, and now from what you just said I think you were saying that you're going to have some at $499 with line of sight down to $300. That's quite a bit lower. So I'm wondering, did something change? Because at those price points, you get a much different demand profile.

Paul Otellini

Separate ultrabook versus notebook.

Stacy Smith

These are touch-enabled notebooks.

Paul Otellini

We have a certain spec for ultrabooks, and that is the product that Stacy said is going to be centered at as low as $599 with some [diverse] SKUs to $499. If you look at touch-enabled Intel based notebooks that are ultrathin and light using non-core processors, those prices are going to be down to as low as $200 probably.