

Intel Price War Causes Casualties

AMD Bears Brunt as Low-End Competition Intensifies; Intel Prices Also Sag



The costs of Intel's price war at the low end are starting to show. The intended target, AMD, is certainly suffering, reporting an operating loss of \$173 million in the second quarter on a 26% decline in CPU revenues. But Intel is also feeling the pain: the company's second-quarter revenue and ASP (average selling price) were both down from the previous quarter, despite expectations that they would be steady. With AMD's Athlon poised to enter the market, the price war could spread to Intel's Pentium III products—which could prove disastrous for both companies.

The genesis of the price war came late last year as Intel's weak Celeron offerings were being hammered by low-end chips from AMD, Cyrix, and even IDT. Whenever Intel's market share dips below 80%, a big red light starts flashing in the CEO's office. In 4Q98, Intel's share of the x86 PC-processor market was only 75%, according to our estimates, with AMD's rising to 14%. CEO Barrett immediately put the Celeron troops on wartime status.

Wasting no time, Intel launched its price war on the first business day of this year by cutting its Celeron prices in half and introducing two new speed grades at once (see MPR 1/25/99, p. 18). Unable to increase its K6 clock speeds as rapidly, AMD saw its ASP plummet from \$89 to \$67 as it matched the Celeron price cuts. As a result, AMD went rapidly into the red after reporting a modest operating profit in 4Q98.

Even as it cut prices, AMD began losing business. Traditionally stingy Intel began offering big discounts off its already low Celeron list prices—anything to get a design win away from the competition. OEM sources report buying Celerons for as little as \$40 earlier this year, despite a minimum list price of about \$65.

As a result of this aggressive campaign, Intel's market share soared to 81%. Most of this gain came from former customers of IBM, which exited the PC-processor business at the end of 1998 with the termination of its Cyrix license. Cyrix had hoped to pick up IBM's customers, but PC makers buying from IBM weren't willing to go with the smaller CPU vendor and switched to Intel instead.

AMD also lost some share to Intel, however, falling to 13% of the market. In the second quarter, the company actually built more than 2.3 million K6 processors that it couldn't sell, due to Intel's aggressive discounting.

Amazingly, Intel reported in the first quarter that its ASP was essentially unchanged from the previous quarter,

despite the Celeron price cuts. In fact, the company says its ASP was flat from 1Q98 through 1Q99, even though Intel was ramping its low-end Celeron line during this period. How could this be?

Intel's trick was to use revenues from its high-priced Xeon products to offset declining prices in PC processors. We estimate that the ASP for Intel's PC processors fell from \$220 in 3Q98 to \$210 in 1Q99, due to the Celeron rollout. The Xeon line, however, made up for this decline by ramping up during this period. As a result, Intel was able to report solid revenues in 1Q99, although they were down somewhat from 4Q98 due to normal seasonal factors.

In the PC-processor market, second-quarter revenues are typically similar to first-quarter revenues, but this time Intel finally took damage from its own price war. We estimate that Intel's PC-processor ASP fell another \$10 in the quarter, too much for Xeon to make up for. As a result, the overall ASP fell from \$225 to \$217, creating a 5% decline in revenue from 1Q99.

Compared with AMD, Intel is hardly in dire straits. But Intel's gains in market share have not been enough to make up for its decline in ASP. Therefore, we have to question the company's wisdom in continuing this campaign.

The key question is how Intel will react to Athlon (also known as the K7). The company has been able to dive-bomb Celeron prices, in part because that brand supplies only 10% of Intel's total CPU revenue and less than 5% of its profits. With 80% of its revenue coming from the Pentium II and Pentium III lines (the remainder is from Xeon), the company must be less callous about hurting its cash cow.

For now, Intel should simply ignore Athlon, waiting to see whether AMD succeeds in bringing the product to market and keeping it competitive. Extending the price war to Athlon will hurt Intel far more than AMD. Intel will ship more than 30 million Pentium II/III chips in 2H99, while AMD isn't likely to ship more than one to two million Athlons. A \$50 price cut in this segment would cost AMD less than \$100 million but would cost Intel about \$1.5 billion. That's not chump change, even for Intel. For the shareholders' sake, it's time to curtail the price war. □

Linley has just completely updated the Intel Microprocessor Forecast, which contains much more data on this subject. For more information, see www.MDRonline.com/tl.